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May 15, 2018

Board of Directors  
Jackson County Schneck Memorial Hospital and Affiliated Organizations  
411 W. Tipton Street  
Seymour, IN 47274

We have reviewed the audit report prepared by Blue & Co., LLC Independent Public Accountants, for the period January 1, 2017 to December 31, 2017. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Report of Independent Auditors, the financial statements included in the report present fairly the financial condition of the Jackson County Schneck Memorial Hospital and Affiliated Organizations, as of December 31, 2017, and the results of its operations for the period then ended, on the basis of accounting described in the report.

The audit report is filed with this letter in our office as a matter of public record.

*Paul D. Joyce*  
Paul D. Joyce, CPA  
State Examiner



# SCHNECK

Better Healthcare Begins Here

## **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AND**

**REQUIRED SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2017 AND 2016**

*CPAs / ADVISORS*



**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

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DECEMBER 31, 2017 AND 2016

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## REPORT OF INDEPENDENT AUDITORS

Board of Trustees  
Jackson County Schneck Memorial Hospital  
and Affiliated Organizations  
Seymour, Indiana

### **Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) and Affiliated Organizations (collectively the "Medical Center"), component units of Jackson County, which comprise the consolidated balance sheets as of December 31, 2017 and 2016 and the related consolidated statements of operations and changes in net position, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Consolidated Financial Statements**

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

### **Auditor's Responsibility**

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

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

Board of Trustees  
Jackson County Schneck Memorial Hospital  
and Affiliated Organizations  
Seymour, 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 Medical Center as of December 31, 2017 and 2016 and the results of its operations, its changes in net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis, and the schedules of pension plan information on pages i-x and 52-53, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Blue & Co., LLC*

Louisville, Kentucky  
April 27, 2018

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2017 AND 2016

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Management's discussion and analysis of the financial performance of Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) (the "Hospital") and Affiliated Organizations (collectively the "Medical Center") provides an overview of the Medical Center's financial activities and performance for the years ended December 31, 2017 and 2016. This discussion and analysis should be read in conjunction with the accompanying Medical Center's consolidated financial statements.

## FINANCIAL HIGHLIGHTS

The Medical Center's net position increased \$32,394,318 from 2016 to 2017. During 2017, the Medical Center's total operating revenue increased by 4.0% to \$286,380,254 with total operating expenses increasing by 4.1% to \$266,188,316.

- The Medical Center raised rates by 4.5% in 2017.
- During the period from 2012 to 2014, the Medical Center assumed ownership of the bed licenses of fifteen long term care facilities. The Medical Center entered into management agreements with the previous owners and/or management entities to manage the day-to-day operations of the facilities. The Medical Center also leases the buildings and premises from the prior owners. The first full year of operations was 2015 with all fifteen facilities included in the Medical Center's financial results. The amount included in income from operations attributable to the nursing facilities was \$12,578,532 in 2017 and \$10,971,694 in 2016.
- The Medical Center purchased the assets of an existing Primary Care Physician Practice and began operating the practice October 1, 2016. The acquisition increased patient volume, positively impacting operating revenue.
- In an effort to increase Medicaid reimbursement to hospitals, the State of Indiana implemented a Hospital Assessment Fee program in 2012. Indiana hospitals are assessed a fee which allows the state to access Federal funds allowing it to pay Medicaid patient claims at higher rates, not to exceed Medicare reimbursement. The Medical Center incurred Hospital Assessment Fees expense of \$5,216,041 in 2017 and \$3,027,163 in 2016.

The Medical Center's net position increased \$23,084,121 from 2015 to 2016. During 2016, the Medical Center's total operating revenue decreased by 3.2% to \$275,329,888 with total operating expenses increasing by 1.6% to \$255,672,055.

- The Medical Center did not raise rates in 2016.
- During the period from 2012 to 2014, the Medical Center assumed ownership of the bed licenses of fifteen long term care facilities. The Medical Center entered into management agreements with the previous owners and/or management entities to manage the day-to-day operations of the facilities. The Medical Center also leases the buildings and premises from the prior owners. The first full year of operations was 2015 with all fifteen facilities included in the Medical Center's financial results. The

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2017 AND 2016

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amount included in income from operations attributable to the nursing facilities was \$10,971,694 in 2016 and \$14,221,972 in 2015.

- The Medical Center purchased the assets of an existing Primary Care Physician Practice and began operating the practice October 1, 2016. The acquisition increased patient volume, positively impacting operating revenue.
- In an effort to increase Medicaid reimbursement to hospitals, the State of Indiana implemented a Hospital Assessment Fee program in 2012. Indiana hospitals are assessed a fee which allows the state to access Federal funds allowing it to pay Medicaid patient claims at higher rates, not to exceed Medicare reimbursement. The Medical Center incurred Hospital Assessment Fees expense of \$3,027,163 in 2016 and \$2,807,078 in 2015.

## FINANCIAL STATEMENTS

The consolidated financial statements of the Medical Center present information about the Medical Center using financial reporting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information. The consolidated balance sheets include all of the Medical Center's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to the Medical Center's creditors (liabilities). It also provides the basis for compiling rate of return, evaluating the capital structure of the Medical Center and assessing the liquidity and financial flexibility of the Medical Center. All of the current and prior year's revenues and expenses are accounted for in the consolidated statements of operations and changes in net position. This statement measures the financial results of the Medical Center's operations and presents revenues earned and expenses incurred. The consolidated statements of cash flows provide information about the Medical Center's cash flows from operating activities, capital and related financing activities, and investing activities, plus provide information on the sources and uses of cash during both the current and prior year.

## FINANCIAL ANALYSIS

The consolidated balance sheets and the consolidated statements of operations and changes in net position report information about the Medical Center's activities. These two statements report the net position of the Medical Center and its changes. Increases or decreases in the Medical Center's net position are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, population changes (including uninsured and medically indigent individuals and families), and new or changed governmental legislation should also be considered.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2017 AND 2016

### CONDENSED FINANCIAL INFORMATION

A summary of the Medical Center's consolidated balance sheets as of December 31, 2017 and 2016 is presented below:

	2017	2016	\$ Change	% Change
<b>Assets</b>				
Current assets	\$ 129,110,782	\$ 124,823,946	\$ 4,286,836	3.4%
Capital assets	81,071,663	75,211,492	5,860,171	7.8%
Other assets	183,964,093	157,667,895	26,296,198	16.7%
Total assets	394,146,538	357,703,333	36,443,205	10.2%
Deferred outflows	4,156,611	5,271,697	(1,115,086)	-21.2%
Total assets and deferred outflows	<u>\$ 398,303,149</u>	<u>\$ 362,975,030</u>	<u>\$ 35,328,119</u>	9.7%
<b>Liabilities</b>				
Current liabilities	\$ 33,450,327	\$ 33,139,133	\$ 311,194	0.9%
Long-term liabilities	35,059,748	34,687,281	372,467	1.1%
Total liabilities	68,510,075	67,826,414	683,661	1.0%
Deferred inflows	2,636,891	386,751	2,250,140	581.8%
Total liabilities and deferred inflows	71,146,966	68,213,165	2,933,801	4.3%
<b>Net position</b>				
Net investment in capital assets	54,544,064	47,052,542	7,491,522	15.9%
Restricted expendable net position	4,983,344	4,784,573	198,771	4.2%
Restricted nonexpendable net position	339,041	310,215	28,826	9.3%
Unrestricted	267,289,734	242,614,535	24,675,199	10.2%
Total net position	<u>327,156,183</u>	<u>294,761,865</u>	<u>32,394,318</u>	11.0%
Total liabilities and net position	<u>\$ 398,303,149</u>	<u>\$ 362,975,030</u>	<u>\$ 35,328,119</u>	9.7%

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2017 AND 2016

A summary of the Medical Center's consolidated balance sheets as of December 31, 2016 and 2015 is presented below:

	2016	2015	\$ Change	% Change
<b>Assets</b>				
Current assets	\$ 124,823,946	\$ 122,674,381	\$ 2,149,565	1.8%
Capital assets	75,211,492	73,735,888	1,475,604	2.0%
Other assets	157,667,895	150,311,421	7,356,474	4.9%
Total assets	357,703,333	346,721,690	10,981,643	3.2%
Deferred outflows	5,271,697	33,168	5,238,529	15793.9%
Total assets and deferred outflows	\$ 362,975,030	\$ 346,754,858	\$ 16,220,172	4.7%
<b>Liabilities</b>				
Current liabilities	\$ 33,139,133	\$ 34,073,442	\$ (934,309)	-2.7%
Long-term liabilities	34,687,281	40,517,071	(5,829,790)	-14.4%
Total liabilities	67,826,414	74,590,513	(6,764,099)	-9.1%
Deferred inflows	386,751	486,601	(99,850)	-20.5%
Total liabilities and deferred inflows	68,213,165	75,077,114	(6,863,949)	-9.1%
<b>Net position</b>				
Net investment in capital assets	47,052,542	39,468,755	7,583,787	19.2%
Restricted expendable net position	4,784,573	5,275,027	(490,454)	-9.3%
Restricted nonexpendable net position	310,215	308,534	1,681	0.5%
Unrestricted	242,614,535	226,625,428	15,989,107	7.1%
Total net position	294,761,865	271,677,744	23,084,121	8.5%
Total liabilities and net position	\$ 362,975,030	\$ 346,754,858	\$ 16,220,172	4.7%

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2017 AND 2016

CONDENSED FINANCIAL INFORMATION

A summary of the Medical Center's consolidated statements of operations and changes in net position for the years ended December 31, 2017 and 2016 is presented below:

	2017	2016	\$ Change	% Change
<b>Operating revenues</b>				
Net patient service revenue	\$ 283,912,929	\$ 272,728,401	\$ 11,184,528	4.1%
Other revenue	2,467,325	2,601,487	(134,162)	-5.2%
Total operating revenues	286,380,254	275,329,888	11,050,366	4.0%
<b>Operating expenses</b>				
Salaries and benefits	151,310,885	142,625,989	8,684,896	6.1%
Supplies and drugs	34,277,174	34,827,374	(550,200)	-1.6%
Depreciation and amortization	8,198,830	8,282,640	(83,810)	-1.0%
Other operating expenses	72,401,427	69,936,052	2,465,375	3.5%
Total operating expenses	266,188,316	255,672,055	10,516,261	4.1%
Income from operations	20,191,938	19,657,833	534,105	2.7%
<b>Nonoperating revenues (expenses)</b>	12,202,380	3,426,288	8,776,092	256.1%
Change in net position	\$ 32,394,318	\$ 23,084,121	\$ 9,310,197	40.3%
<b>Net position, end of year</b>	\$ 327,156,183	\$ 294,761,865	\$ 32,394,318	11.0%

A summary of the Medical Center's consolidated statements of operations and changes in net position for the years ended December 31, 2016 and 2015 is presented below:

	2016	2015	\$ Change	% Change
<b>Operating revenues</b>				
Net patient service revenue	\$ 272,728,401	\$ 282,563,218	\$ (9,834,817)	-3.5%
Other revenue	2,601,487	1,821,601	779,886	42.8%
Total operating revenues	275,329,888	284,384,819	(9,054,931)	-3.2%
<b>Operating expenses</b>				
Salaries and benefits	142,625,989	137,137,726	5,488,263	4.0%
Supplies and drugs	34,827,374	33,633,994	1,193,380	3.5%
Depreciation and amortization	8,282,640	8,639,376	(356,736)	-4.1%
Other operating expenses	69,936,052	72,234,512	(2,298,460)	-3.2%
Total operating expenses	255,672,055	251,645,608	4,026,447	1.6%
Income from operations	19,657,833	32,739,211	(13,081,378)	-40.0%
<b>Nonoperating revenues (expenses)</b>	3,426,288	(1,165,197)	4,591,485	394.1%
Change in net position	\$ 23,084,121	\$ 31,574,014	\$ (8,489,893)	-26.9%
<b>Restatement due to GASB 68</b>	\$ -0-	\$ 7,085,702	\$ (7,085,702)	100.0%
<b>Net position, end of year</b>	\$ 294,761,865	\$ 271,677,744	\$ 23,084,121	8.5%

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2017 AND 2016

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SOURCES OF REVENUE

The Medical Center derives the majority of its revenue from charges for patient care and related services. The Medical Center is reimbursed for services from a variety of sources including the Medicare and Medicaid programs, insurance carriers, managed care plans, and patients. The Medical Center has established payment arrangements with Medicare, Medicaid, and various commercial insurance carriers. Services provided under those arrangements are paid at predetermined rates and/or reimbursable cost as defined. Provisions have been made in the consolidated financial statements for contractual adjustments representing the difference between the standard charges for services and the actual or estimated payment.

The Medical Center's percentages of gross revenue by payor for 2017, 2016, and 2015 are as follows:

<u>Payor Mix</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Medicare	40 %	38 %	39 %
Medicaid	27	28	26
Blue Cross	16	14	15
SIHO*	4	5	5
Other third-party payors	7	8	7
Self-pay	6	7	8
Total	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

\*Southeastern Indiana Health Organization

OPERATING AND FINANCIAL PERFORMANCE

The Medical Center's financial performance from operations was positive in 2017, as well as greater in comparison to 2016. The same is true for the Medical Center's overall financial performance. A discussion of the highlights of 2017 operations and changes in activity is presented below:

Revenues

The Medical Center's net patient service revenues increased by \$11,184,528 in 2017. Highlights of this change are as follows:

- The Medical Center raised rates by 4.5% in 2017.
- The Medical Center acquired a primary care practice and established several specialty practices in the latter part of 2016.
- Upper Payment Limit (UPL) revenue relating to ownership of fifteen nursing home licenses increased approximately \$3.3 million from 2016 to 2017. UPL revenue is reliant on each home's Medicaid days and per day rate.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2017 AND 2016

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- Patient volume increases were noted for surgeries, laboratory tests, diagnostic imaging procedures, physical therapy, occupational therapy, and speech therapy. Patient volume decreases were noted in inpatient days, births, emergency department visits, respiratory therapy, home health and hospice services.

### Expenses

Total operating expenses increased by \$10,516,261 in 2017. Highlights of this change are as follows:

- Salary and benefits costs increased \$8,684,896. This was due to staffing needs, market wage adjustments for many positions, the addition of a primary care practice and several specialty practices the latter part of 2016, the addition of several new providers in 2017, and the benefits related to the increased number of employees.
- Hospital assessment fee increased \$2,188,878. The State determines the hospital assessment fee due from each facility, which in turn allows the State to leverage Federal funds and increase Medicaid reimbursement of patient claims.

The Medical Center's financial performance from operations was positive in 2016, though lower in comparison to 2015. The same is true for the Medical Center's overall financial performance. A discussion of the highlights of 2016 operations and changes in activity is presented below:

### Revenues

The Medical Center's net patient service revenues decreased by \$9,834,817 in 2016. Highlights of this change are as follows:

- There was no rate increase in 2016.
- Contractual adjustments as a percent of gross revenue increased in 2016 due to shifts in patient types and insurance payer mix.
- Upper Payment Limit (UPL) revenue relating to ownership of fifteen nursing home licenses decreased approximately \$6.4 million from 2015 to 2016. UPL revenue is reliant on each home's Medicaid days and per day rate.
- Patient volume increases were noted for births, emergency department visits, surgeries, laboratory tests, diagnostic imaging procedures, respiratory therapy, occupational therapy, and home health services. Patient volume decreases were noted in inpatient days, physical therapy, speech therapy, and hospice services.

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2017 AND 2016

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Expenses

Total operating expenses increased by \$4,026,447 in 2016. Highlights of this change are as follows:

- Salary and benefits costs increased \$5,488,263. This was due to staffing needs, market wage adjustments for many positions, and the addition of a primary care practice and several specialty physicians.
- Purchased services expense decreased \$1,831,508 due primarily to purchased services relating to the fifteen long term care facilities.

FINANCIAL ANALYSIS – CASH FLOWS

The Medical Center's 2017 cash flows increased \$14,130,018 due primarily to positive cash inflows received for patient services and investment income, which exceeded cash outflows for cash paid to employees and vendors and purchases of capital assets. In addition, the Medical Center was able to increase investment activity in 2017.

The Medical Center's 2016 cash flows increased \$18,519,130 due primarily to positive cash inflows received for patient services and investment income, which exceeded cash outflows for cash paid to employees and vendors and purchases of capital assets. In addition, the Medical Center was able to increase investment activity in 2016.

Capital Assets

	2017	2016	\$Change	%Change
Land and land improvements	\$ 13,122,140	\$ 12,436,637	\$ 685,503	5.5%
Leasehold improvements	866,949	671,058	195,891	29.2%
Buildings	93,757,257	87,948,639	5,808,618	6.6%
Equipment	58,550,124	56,173,446	2,376,678	4.2%
Construction in progress	5,565,424	4,522,214	1,043,210	23.1%
	<u>171,861,894</u>	<u>161,751,994</u>	<u>10,109,900</u>	<u>6.3%</u>
Less accumulated depreciation	<u>90,790,231</u>	<u>86,540,502</u>	<u>4,249,729</u>	<u>4.9%</u>
Capital assets, net	<u>\$ 81,071,663</u>	<u>\$ 75,211,492</u>	<u>\$ 5,860,171</u>	<u>7.8%</u>

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2017 AND 2016

Net capital assets increased in 2017 due to capital purchases exceeding annual depreciation and the disposal of assets that have exhausted their useful lives. Buildings increased significantly due to the purchase of additional property and the completion of several large projects.

	2016	2015	\$Change	%Change
Land and land improvements	\$ 12,436,637	\$ 12,147,614	\$ 289,023	2.4%
Leasehold improvements	671,058	671,058	-0-	0.0%
Buildings	87,948,639	86,982,502	966,137	1.1%
Equipment	56,173,446	59,185,699	(3,012,253)	-5.1%
Construction in progress	4,522,214	1,147,873	3,374,341	294.0%
	<u>161,751,994</u>	<u>160,134,746</u>	<u>1,617,248</u>	1.0%
Less accumulated depreciation	<u>86,540,502</u>	<u>86,398,858</u>	<u>141,644</u>	0.2%
Capital assets, net	<u>\$ 75,211,492</u>	<u>\$ 73,735,888</u>	<u>\$ 1,475,604</u>	2.0%

Net capital assets increased in 2016 due to capital purchases exceeding annual depreciation and the disposal of assets that have exhausted their useful lives.

See additional information on capital assets in the notes to the consolidated financial statements in footnote number 5.

Long-Term Debt

At December 31, 2017, the Medical Center had long-term debt (including current portion) of \$26,527,599, which is comprised of revenue bonds outstanding.

At December 31, 2016, the Medical Center had long-term debt (including current portion) of \$28,158,950, which is comprised of revenue bonds outstanding.

**ECONOMIC FACTORS AND 2018 BUDGET**

The Medical Center's Board and management considered many factors when establishing the 2018 budget. Included was the status of the economy, which takes into consideration market factors and other environmental factors such as the following items:

- Advances in medical equipment and information systems technology and the need to replace obsolete equipment
- Decreasing reimbursement from governmental and commercial insurance payors
- Increasing costs of supplies and services
- Nationwide workforce shortages in nursing and other healthcare specialist positions
- Expectation to maintain high quality of care

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2017 AND 2016

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- Patient sensitivity to amount charged for services provided
- Community need of greater access to healthcare
- Increased competition from niche providers
- Size, composition, and needs of the Medical Center's physician medical staff

## CONTACTING THE MEDICAL CENTER

This report is designed to provide our citizens, customers and creditors with a general overview of the Medical Center's finances. These consolidated financial statements include the activities of the Hospital, Jackson County Schneck Memorial Hospital Foundation (the "Foundation"), Jackson Medical Building, LLC, and Health Development Corporation and Affiliated Organization ("HDC"). Separately-issued audited financial statements are available for both HDC and the Foundation. If you have questions about this report or need additional information, contact Deborah Mann, Vice President of Finance at 812-522-0171.

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**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2017 AND 2016

	2017	2016
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 76,168,621	\$ 69,096,172
Investments	8,743,565	8,411,773
Patient accounts receivable, net of estimated uncollectibles of \$28,671,204 in 2017 and \$26,829,458 in 2016	28,434,115	28,574,485
Inventories	3,959,066	4,129,678
Prepaid expenses and other current assets	9,281,121	11,791,873
Estimated third-party payor settlements	-0-	384,109
Physician recruitment guarantees, current portion	93,750	110,000
Other assets, current portion	561,722	499,629
Current portion of assets whose use is limited	1,868,822	1,826,227
Total current assets	129,110,782	124,823,946
<b>Assets whose use is limited, net of amount required to meet current obligations</b>	165,914,780	145,166,964
<b>Capital assets, net</b>	81,071,663	75,211,492
<b>Net pension asset</b>	9,351,628	5,852,824
<b>Other long-term assets</b>		
Physician recruitment guarantees, net of current portion	581,250	-0-
Other assets, net of current portion	8,116,435	6,648,107
Total other long-term assets	8,697,685	6,648,107
Total assets	394,146,538	357,703,333
<b>Deferred outflows</b>		
Pension and goodwill deferred outflows	4,156,611	5,271,697
Total deferred outflows	4,156,611	5,271,697
Total assets and deferred outflows	\$ 398,303,149	\$ 362,975,030

*See accompanying notes to consolidated financial statements.*

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2017 AND 2016

**LIABILITIES AND NET POSITION**

	2017	2016
<b>Current liabilities</b>		
Accounts payable	\$ 20,429,659	\$ 21,190,092
Accrued personnel costs	10,831,092	9,961,117
Accrued expenses	210,998	246,573
Estimated third-party payor settlements	183,477	-0-
Physician recruitment guarantees, current portion	93,750	110,000
Current portion of long-term debt	1,701,351	1,631,351
Total current liabilities	33,450,327	33,139,133
<b>Long-term liabilities</b>		
Long-term debt, net of current portion	24,826,248	26,527,599
Deferred compensation liabilities	9,652,250	8,159,682
Physician recruitment guarantees, net of current portion	581,250	-0-
Total long-term liabilities	35,059,748	34,687,281
<b>Pension deferred inflows</b>	2,636,891	386,751
Total liabilities and deferred inflows	71,146,966	68,213,165
<b>Net position</b>		
Net investment in capital assets	54,544,064	47,052,542
Restricted		
Expendable for debt service	3,142,373	3,102,106
Expendable for donor-restricted purposes	1,840,971	1,682,467
Nonexpendable perpetual trust	339,041	310,215
Unrestricted	267,289,734	242,614,535
Total net position	327,156,183	294,761,865
Total liabilities and net position	\$ 398,303,149	\$ 362,975,030

*See accompanying notes to consolidated financial statements.*

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION  
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
<b>Operating revenues</b>		
Net patient service revenue	\$ 283,912,929	\$ 272,728,401
Other revenue	2,467,325	2,601,487
Total operating revenues	<u>286,380,254</u>	<u>275,329,888</u>
<b>Operating expenses</b>		
Salaries and wages	134,772,994	128,852,488
Employee benefits and payroll taxes	16,537,891	13,773,501
Professional medical fees	2,275,803	1,772,448
Medical supplies	14,774,006	14,655,221
Other supplies	8,185,237	8,564,185
Drugs	11,317,931	11,607,968
Purchased services	28,255,132	29,356,940
Utilities	4,741,140	4,631,186
Insurance	3,218,655	2,981,683
Depreciation and amortization	8,198,830	8,282,640
Rent	20,551,628	19,842,007
Hospital assessment fee	5,216,041	3,027,163
Other operating expenses	8,143,028	8,324,625
Total operating expenses	<u>266,188,316</u>	<u>255,672,055</u>
Income from operations	20,191,938	19,657,833
<b>Nonoperating revenues (expenses)</b>	<u>12,202,380</u>	<u>3,426,288</u>
Change in net position	32,394,318	23,084,121
<b>Net position, beginning of year</b>	<u>294,761,865</u>	<u>271,677,744</u>
<b>Net position, end of year</b>	<u><u>\$ 327,156,183</u></u>	<u><u>\$ 294,761,865</u></u>

See accompanying notes to consolidated financial statements.

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
<b>Operating activities</b>		
Cash received for patient services	\$ 284,620,885	\$ 272,667,336
Cash paid to/for employees	(149,200,486)	(143,245,211)
Cash paid to vendors and suppliers	(104,853,806)	(107,819,490)
Other receipts, net	2,467,325	2,601,487
Net cash flows from operating activities	33,033,918	24,204,122
<b>Noncapital financing activities</b>		
Noncapital contributions	1,014,766	747,405
<b>Capital and related financing activities</b>		
Principal payments on long-term debt	(1,605,000)	(6,035,000)
Interest paid	(755,275)	(1,088,173)
Purchase of capital assets	(14,160,172)	(9,949,159)
Proceeds from sale of capital assets	209,361	306,350
Change in bond premiums	(26,351)	(73,183)
(Gain) loss on disposal of capital assets	70,937	79,242
Net cash flows from capital and related financing activities	(16,266,500)	(16,759,923)
<b>Investing activities</b>		
Investment income	12,073,923	4,072,620
Other nonoperating revenues (expenses)	(131,034)	(305,564)
Change in investments	(331,792)	(68,801)
Change in assets whose use is limited	(13,732,842)	7,040,213
Change in other assets	(1,530,421)	(410,942)
Net cash flows from investing activities	(3,652,166)	10,327,526
Net change in cash and cash equivalents	14,130,018	18,519,130
<b>Cash and cash equivalents, beginning of year</b>	138,209,646	119,690,516
<b>Cash and cash equivalents, end of year</b>	\$ 152,339,664	\$ 138,209,646
<b>Reconciliation of cash and cash equivalents to the balance sheets</b>		
Cash and cash equivalents in current assets	\$ 76,168,621	\$ 69,096,172
Cash and cash equivalents in assets whose use is limited	76,171,043	69,113,474
Total cash and cash equivalents	\$ 152,339,664	\$ 138,209,646

*See accompanying notes to consolidated financial statements.*

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
<b>Reconciliation of income from operations to net cash and cash equivalents from operating activities</b>		
Income from operations	\$ 20,191,938	\$ 19,657,833
Adjustments to reconcile income from operations to net cash flows from operating activities		
Depreciation	8,080,264	8,280,140
Amortization	118,566	2,500
Provision for bad debts	17,069,320	16,437,849
Changes in operating assets and liabilities		
Patient accounts receivable	(16,928,950)	(16,802,742)
Inventories	170,612	114,560
Prepaid expenses and other current assets	2,510,752	(2,440,359)
Net pension asset	(3,498,804)	4,502,401
Pension and goodwill deferred outflows	996,520	(5,238,529)
Accounts payable	(820,994)	(623,916)
Accrued personnel costs	869,975	(237,586)
Accrued expenses	(35,575)	(106,349)
Estimated third-party payor settlements	567,586	303,828
Pension deferred inflows	2,250,140	(99,850)
Deferred compensation liabilities	1,492,568	454,342
Net cash flows from operating activities	\$ 33,033,918	\$ 24,204,122
<b>Supplemental disclosures of noncash operating and capital and related financing activities</b>		
Property and equipment acquired included in accounts payable	\$ 60,561	\$ 192,177

*See accompanying notes to consolidated financial statements.*

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2017 AND 2016

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## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Nature of Operations

Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) (the "Hospital") is a not-for-profit, acute care hospital located in Seymour, Indiana. The Hospital is county owned and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital is organized for the purpose of providing healthcare services to the residents of Jackson County and the surrounding area. The Hospital's primary sources of support are from patient revenues and other ancillary income. Patient revenues include funds received from Medicare, state agencies, insurance companies, and the patients themselves.

Pursuant to the provision of long-term care, the Hospital owns the operations of fifteen 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 performance of all activities of the managers shall be on behalf of the Hospital and the Hospital retains the authority for the operation of the facilities.

The Hospital has entered into lease agreements with the long-term care facilities, collectively referred to as the Lessors, to lease the facilities. Concurrently, the Hospital entered into agreements with the long-term care facilities to manage the above leased facilities, collectively referred to as the Managers. As part of the agreements, the Hospital will pay 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' initial terms expire at various times beginning in 2016 and beyond. 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. Other current assets and liabilities include certain reimbursement receivables, accrued fees and expenses, and working capital balances related to the long-term care facilities.

Health Development Corporation ("HDC") is a not-for-profit corporation located in Seymour, Indiana. HDC was organized to operate exclusively for the benefit of, to perform the functions of, and to carry out the purposes of the Hospital by recruiting physicians to the surrounding area and by providing medical education programs to the medical and Hospital staff. HDC's primary sources of revenue are from service fees charged to the Hospital.

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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HDC's consolidated financial statements at December 31, 2017 and 2016, include the accounts of Coordinated Health, LLC (the "Clinic"). The Clinic is wholly-owned by HDC and began operations in 2002. The Clinic was organized to operate exclusively for the benefit of HDC and the purposes for which HDC is organized and operated, including the promotion and support of the health of Jackson County, Indiana residents and residents of surrounding communities. Currently, the Clinic operates three healthcare facilities located in North Vernon, Salem, and Scottsburg, Indiana. The Clinic's primary source of revenue is from patient services.

The Jackson County Schneck Memorial Hospital Foundation, Inc. (d/b/a Schneck Medical Center Foundation) (the "Foundation") is a not-for-profit organization located in Seymour, Indiana. The Foundation operates for the benefit of the Hospital. The Foundation's main sources of revenue are earnings on investments, donations received, and rental income.

Jackson Medical Building, LLC ("JMB") is a limited liability company that is wholly owned by the Hospital. JMB was organized to own and operate a medical office building located on the Hospital's campus. JMB's primary source of revenue is from rental income.

The significant accounting policies followed by the Hospital, HDC, JMB, and the Foundation (collectively the "Medical Center") in the preparation of the consolidated financial statements are summarized below:

Reporting Entity and Consolidation Policy

The accompanying consolidated financial statements include the accounts of the Hospital, HDC, the Clinic, JMB, and the Foundation. The Board of County Commissioners of Jackson County appoints the governing Board of Trustees of the Hospital, and a financial benefit/burden relationship exists between the Hospital and the Jackson County government. For these reasons, the Hospital is considered a component unit of Jackson County. Similarly, due to their organized purposes, HDC, the Clinic, JMB, and the Foundation are considered blended component units of the Hospital. Intercompany transactions and balances have been eliminated in consolidation. The separate audited financial statements of HDC (including the Clinic) and the Foundation may be obtained by contacting the Hospital as follows:

Schneck Medical Center  
411 W. Tipton Street  
P.O. Box 2349  
Seymour, IN 47274

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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### Management's Estimates

Management uses estimates and assumptions in preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if any, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

### New Accounting Standards

During 2017, the Medical Center implemented Governmental Accounting Standards Board (GASB) Statement No. 82 *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*. This statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. There was no material impact to these financial statement disclosures as a result of adoption of this standard as these disclosures have been provided historically. There was no material impact to these financial statement disclosures as a result of adoption of this standard.

During 2017, the Medical Center implemented GASB Statement No. 81 *Irrevocable Split-Interest Agreements*. This Statement improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period. There was no material impact to these financial statement disclosures as a result of adoption of this standard.

During 2017, the Medical Center implemented GASB Statement No. 80 *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*. This Statement improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity, as amended*. The Statement also amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. There was no material impact to these financial statement disclosures as a result of adoption of this standard.

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**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2017 AND 2016

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Measurement Focus and Basis of Accounting

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

Pensions

For purposes of measuring the net pension asset, deferred outflows, and deferred inflows of resources related to pensions, pension expense, information about the fiduciary net position of the Jackson County Schneck Memorial Hospital Employees' Pension Plan (the "Plan"), and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported by the Plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Risk Management

The Medical Center is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The Medical Center is insured for medical malpractice claims and judgments.

Cash and Cash Equivalents

Cash and cash equivalents as reported on the consolidated balance sheets include petty cash and other cash on hand amounts, checking accounts, and savings accounts that are readily available for use. Cash and cash equivalents as reported on the consolidated statements of cash flows include investments in highly liquid assets with maturity dates of 90 days or less when purchased.

Investments

Investments include certificates of deposit amounts maturing within one year of the dates of the consolidated balance sheets. Investments are recorded at cost, which approximates market value.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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### Patient Accounts Receivable and Net Patient Service Revenue

The Medical Center recognizes net patient service revenues on the accrual basis of accounting in the reporting period in which services are performed based on the current gross charge structure, less actual adjustments and estimated discounts for contractual allowances, principally for patients covered by Medicare, Medicaid, managed care, and other health plans. Gross patient service revenue is recorded in the accounting records using the established rates for the types of service provided to the patient. The Medical Center recognizes an estimated contractual allowance to reduce gross patient charges to the estimated net realizable amount for service rendered based upon previously agreed-to rates with a payor. The Medical Center utilizes the patient accounting system to calculate contractual allowances on a payor-by-payor basis based on the rates in effect for each primary third-party payor. Another factor that is considered and could further influence the level of the contractual reserves includes the status of accounts receivable balances as inpatient or outpatient. The Medical Center's management continually reviews the contractual estimation process to consider and incorporate updated laws and regulations and the frequent changes in managed care contractual terms that result from contract negotiations and renewals.

Payors include federal and state agencies, including Medicare and Medicaid, managed care health plans, commercial insurance companies, and patients. These third-party payors provide payments to the Medical Center at amounts different from its established rates based on negotiated reimbursement agreements. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and fee schedule payments. Retroactive adjustments under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

### Allowance for Doubtful Accounts

Accounts receivable are reduced by an allowance for doubtful accounts based on the Medical Center's evaluation of its major payor sources of revenue, the aging of the accounts, historical losses, current economic conditions, and other factors unique to the service area and the healthcare industry. Management regularly reviews data about the major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party payor coverage, the Medical Center analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulty that make the realization of amounts due unlikely). For receivables associated with self-pay payments, which includes both patients without insurance and patient with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Medical Center records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

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**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2017 AND 2016

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The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts. The December 31, 2017 and 2016 allowance for doubtful accounts balances were comprised of the following:

	2017	2016
Reserve for third-party payor balances	\$ 7,106,813	\$ 4,898,396
Reserve for self-pay balances	21,564,391	21,931,062
Total allowance for doubtful accounts	\$ 28,671,204	\$ 26,829,458

Inventories

Inventories consist of medical supplies, pharmaceuticals, and office supplies and are valued at the lower of cost or market, with cost being determined on the first-in, first-out (FIFO) method.

Assets Whose Use is Limited

Investments in certificates of deposit are reported in the consolidated financial statements at cost, which approximates fair value.

Assets whose use is limited include assets set aside by the respective Boards for future capital improvements, over which the Boards retain control and may at their discretion subsequently use for other purposes; assets held by trustees under indenture agreements; assets that have been restricted by donors for specific purposes; and amounts that have been set aside as part of deferred compensation plans.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair market value in the consolidated balance sheets. Investment income or loss, including realized gains and losses on investments and assets whose use is limited, net change in the market value of assets whose use is limited, interest, and dividends, is included in nonoperating revenues (expenses) when earned.

Capital Assets

The Medical Center's capital assets are reported at historical cost and include expenditures for additions and repairs which substantially increase the useful lives of capital assets. Maintenance, repairs, and minor improvements are expensed as incurred. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land and construction in progress are depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association Guide for Estimated Useful Lives for Fixed Assets.

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# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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### Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest costs on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. For the years ended December 31, 2017 and 2016, the Medical Center capitalized interest costs of \$168,122 and \$108,344, respectively.

### Pension and Goodwill Deferred Outflows

The Medical Center purchased certain assets of a physical practice resulting in a recognition of goodwill in the amount of \$1,075,000. Goodwill is being amortized over 136 months. The amount of unamortized goodwill at December 31, 2017 and 2016 was \$956,434 and \$1,075,000, respectively.

### Classification of Net Position

The net position of the Medical Center is classified in four components. (1) *Net investment in capital assets* consists of capital assets net of accumulated depreciation plus deferred outflows related to losses on bond refunding which are reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. (2) *Restricted expendable net position* includes assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center, including amounts deposited with trustees as required by revenue bond indentures. (3) *Restricted nonexpendable net position* includes the principal portion of permanent endowments and non-controlling interests owned by external investors. (4) *Unrestricted net position* is the remaining net position that does not meet the definition of *net investment in capital assets* or *restricted*. When both restricted and unrestricted resources are available for use, the Medical Center's policy is to use restricted resources first, then unrestricted resources as they are needed.

### Consolidated Statements of Operations and Changes in Net Position

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. Peripheral and incidental transactions are reported as nonoperating revenues (expenses). Nonoperating revenues (expenses) which are excluded from income from operations include investment income, contributions received, restricted expenditures, and the net change in the market value of assets whose use is limited.

### Advertising and Marketing Costs

Advertising and marketing costs are charged to operations when incurred. Advertising and marketing costs charged to operations were \$1,010,365 and \$914,426 for the years ended December 31, 2017 and 2016, respectively.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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### Charity Care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are reported as reductions of net patient service revenue.

### Income Taxes

The Hospital has been granted exemption from taxation as a not-for-profit organization by the Internal Revenue Service under Section 115, and in 2005 was also granted exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code for purposes of maintaining a 403b deferred compensation plan. Therefore, no provision for income taxes has been provided in the consolidated statements of operations and changes in net position. HDC and the Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. As such HDC and the Foundation are generally exempt from income taxes. However, HDC and the Foundation are required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only. The Clinic and JMB are both organized as a single-member Limited Liability Company (LLC). As of December 31, 2017, the 2013 - 2017 income tax years are still open for tax examinations for both the Clinic and JMB. HDC is the sole member of the Clinic, and the Hospital is the sole member of JMB. As such, the Clinic and JMB are not required to file separate State or Federal tax returns. For tax reporting purposes, all activities of the Clinic are required to be filed with the activities of HDC, and all activities of JMB are required to be filed with the activities of the Hospital.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by each entity comprising the Medical Center and recognize a tax liability if any Medical Center entity has taken an uncertain tax 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 each entity of the Medical Center, and has concluded that as of December 31, 2017 and 2016, 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. Each entity of the Medical Center is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

### Grants and Contributions

From time to time, the Medical Center receives grants as well as 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 restricted to a specific operating purpose are reported as nonoperating revenues.

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**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2017 AND 2016

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Physician Recruitment Guarantees

GASB Statement No. 62 requires the Medical Center to report a liability for physician revenue guarantees on its consolidated balance sheets at fair value and amortize that liability and corresponding intangible asset over the income guarantee period. As cash payments are made to the physicians in accordance with the terms of the income guarantees, the Medical Center records a note receivable from each participating physician. These notes are either paid back to the Medical Center or are forgiven by the Medical Center in accordance with the terms of each separate income guarantee agreement. As of December 31, 2017 and 2016, the Medical Center had matching assets and liabilities relating to physician guarantees of \$675,000 and \$110,000, respectively.

Subsequent Events

The Medical Center has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is April 27, 2018.

Reclassifications

Certain reclassifications have been made to the 2016 financial statements to correspond to the current year's format. Total net position and change in net position are unchanged due to these reclassifications.

**2. DEPOSITS AND INVESTMENTS**

Deposits and investments are comprised of the following at December 31, 2017 and 2016:

	2017	2016
Carrying amount		
Cash and cash equivalents	\$ 152,339,664	\$ 138,209,646
Certificates of deposit	14,000,000	17,003,892
Brokered certificates of deposit	162,049	149,288
Mutual funds	76,525,343	62,768,201
Corporate bonds	16,243	36,577
Money market mutual funds	7,787,928	4,692,955
Perpetual trust	339,041	310,215
Interest receivable	39,826	19,687
Fixed income guaranteed option	71,161	193,448
Common stocks	1,414,533	1,117,227
Total	\$ 252,695,788	\$ 224,501,136

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2017 AND 2016

	2017	2016
Included in the consolidated balance sheet captions:		
Cash and cash equivalents	\$ 76,168,621	\$ 69,096,172
Investments	8,743,565	8,411,773
Assets whose use is limited	167,783,602	146,993,191
<b>Total</b>	<b>\$ 252,695,788</b>	<b>\$ 224,501,136</b>

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the Medical Center's deposits may not be returned to it. The Medical Center does not have a deposit policy for custodial credit risk. Deposits with financial institutions in the State of Indiana at year-end were entirely insured by the Federal Depository Insurance Corporation ("FDIC") or by the Indiana Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying institution.

Investments are carried at fair value or cost which approximates fair value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. As of December 31, 2017 and 2016, the Medical Center had the following investments and maturities, all of which were held in the Medical Center's name by custodial banks or investment companies that are agents of the Medical Center:

	December 31, 2017				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
Certificates of deposit	\$ 14,162,049	\$ 14,000,000	\$ 20,316	\$ 141,733	\$ -0-
Corporate bonds	16,243	14,110	2,133	-0-	-0-
<b>Total</b>	<b>\$ 14,178,292</b>	<b>\$ 14,014,110</b>	<b>\$ 22,449</b>	<b>\$ 141,733</b>	<b>\$ -0-</b>

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	December 31, 2016				
	Carrying Amount	Investment Maturities (in years)			More than 10
		Less than 1	1 - 5	6 - 10	
Certificates of deposit	\$ 17,153,180	\$ 17,153,180	\$ -0-	\$ -0-	\$ -0-
Corporate bonds	36,577	16,486	20,091	-0-	-0-
<b>Total</b>	<b>\$ 17,189,757</b>	<b>\$ 17,169,666</b>	<b>\$ 20,091</b>	<b>\$ -0-</b>	<b>\$ -0-</b>

Interest Rate Risk

Interest risk rate is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

The Medical Center does have formal investment policies that limit investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates. The Hospital's current investment policy limits investments with maturities of two years or longer to no more than 60 percent of total investments. The Foundation's investment policy prohibits the purchase of fixed income securities with original maturities of more than 10 years, unless the securities are part of a fund portfolio which has an average maturity of not greater than 10 years.

Credit Risk – Investments

Credit risk is the risk that, in the event of a failure of a financial institution, the Medical Center would not be able to recover deposits, the value of its investments, or collateral securities that are in the possession of an outside party.

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

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Investment Type	Credit Rating Moody's	Fair Value 2017	Fair Value 2016
Corporate bonds	A1	\$ 2,003	\$ 2,084
Corporate bonds	A2	4,055	4,216
Corporate bonds	A3	-0-	10,337
Corporate bonds	Aaa	-0-	2,059
Corporate bonds	Aa2	4,018	4,195
Corporate bonds	Ba1	2,132	4,314
Corporate bonds	Baa1	-0-	3,145
Corporate bonds	Baa2	4,035	4,197
Corporate bonds	Baa3	-0-	2,030
		\$ 16,243	\$ 36,577

Concentration of Credit Risk

The Hospital places no limit on the amount it may invest in any one issuer. The Foundation limits investments in securities of a single issuer to 10 percent of the portfolio's total market value. This limitation does not include U.S. Government Securities. The Medical Center maintains its investments, which at times may exceed federally insured limits. The Medical Center has not experienced any losses in such accounts. The Medical Center believes that it is not exposed to any significant credit risk on investments.

Fair Value Measurements and Disclosures

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 market 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 Medical Center 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.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

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- 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 at December 31, 2017 and 2016.

- *Brokered Certificates of Deposit*: Determined by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the credit-worthiness of the issuer.
- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Medical Center 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 Medical Center are deemed to be actively traded.
- *Corporate bonds*: Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.
- *Perpetual trust*: Valued at fair value as reported by the trustee, which represents the Medical Center's *pro rata* interest in the net position of the trust, substantially all of which are valued on a mark-to-market basis.
- *Fixed income guaranteed option*: Guaranteed investment contracts are valued at fair value by the insurance company by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer. Since the participants transact at contract value, fair value is determined annually for financial statement reporting purposes only. In determining the reasonableness of the methodology the Finance Committee evaluates a variety of factors including review of existing contracts, economic conditions, industry and market developments, and overall credit ratings. Certain unobservable inputs are assessed through review of contract terms (for example, duration or payout date) while others are substantiated utilizing available market data (for example, swap curve rate).
- *Common stocks*: Valued at the closing price reported on the active market on which the individual securities are traded.

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- *Deferred compensation:* Value based on the underlying investments.
- *Money market mutual funds:* Generally transact subscription and redemption activity at a \$1 stable net asset value (NAV) however, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities held in the fund.

The following table set forth by level, within the hierarchy, the Medical Center's assets measured at fair value on a recurring basis as of December 31, 2017 are as follows:

	Level 1	Level 2	Level 3	Total
<u>Assets</u>				
Common stocks				
Basic materials	\$ 124,059	\$ -0-	\$ -0-	\$ 124,059
Consumer goods	224,830	-0-	-0-	224,830
Consumer services	73,104	-0-	-0-	73,104
Financials	336,333	-0-	-0-	336,333
Healthcare	180,222	-0-	-0-	180,222
Industrials	165,941	-0-	-0-	165,941
Technology	307,205	-0-	-0-	307,205
Utilities	2,839	-0-	-0-	2,839
	1,414,533	-0-	-0-	1,414,533
Mutual funds				
Large cap	28,723,668	-0-	-0-	28,723,668
Mid cap	15,136,685	-0-	-0-	15,136,685
Small cap	3,511,881	-0-	-0-	3,511,881
Foreign small	3,203,290	-0-	-0-	3,203,290
Foreign large	10,200,631	-0-	-0-	10,200,631
World stock	5,049,670	-0-	-0-	5,049,670
Diversified emerging markets	1,865,254	-0-	-0-	1,865,254
Intermediate term bond	4,059,346	-0-	-0-	4,059,346
Short term bond	382,663	-0-	-0-	382,663
Real estate	34,471	-0-	-0-	34,471
High yield bond	387,570	-0-	-0-	387,570
Government	3,547,053	-0-	-0-	3,547,053
Bank loan	19,698	-0-	-0-	19,698
Preferred stock	14,122	-0-	-0-	14,122
Inflation protected bond	385,670	-0-	-0-	385,670
Balanced fund	3,671	-0-	-0-	3,671
	76,525,343	-0-	-0-	76,525,343

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	Level 1	Level 2	Level 3	Total
Money market mutual funds	-0-	7,787,928	-0-	7,787,928
Perpetual trust, held by trustee	-0-	-0-	339,041	339,041
Fixed income investments				
Brokered certificates of deposit	-0-	162,049	-0-	162,049
Corporate bonds	-0-	16,243	-0-	16,243
Fixed income guaranteed option	-0-	71,161	-0-	71,161
Total fixed income investments	-0-	249,453	-0-	249,453
Total assets at fair value	<u>\$ 77,939,876</u>	<u>\$ 8,037,381</u>	<u>\$ 339,041</u>	86,316,298
Cash and cash equivalents				152,339,664
Certificates of deposit				14,000,000
Interest receivable				39,826
Total deposits and investments				<u>\$ 252,695,788</u>
<u>Liabilities</u>				
Deferred compensation liabilities	<u>\$ -0-</u>	<u>\$ (9,652,250)</u>	<u>\$ -0-</u>	<u>\$ (9,652,250)</u>

The following table set forth by level, within the hierarchy, the Medical Center's asset measured at fair value on a recurring basis as of December 31, 2016 are as follows:

	Level 1	Level 2	Level 3	Total
<u>Assets</u>				
Common stocks				
Basic materials	\$ 130,286	\$ -0-	\$ -0-	\$ 130,286
Consumer goods	157,946	-0-	-0-	157,946
Consumer services	125,169	-0-	-0-	125,169
Financials	227,608	-0-	-0-	227,608
Healthcare	155,850	-0-	-0-	155,850
Industrials	97,660	-0-	-0-	97,660
Technology	2,681	-0-	-0-	2,681
Utilities	220,027	-0-	-0-	220,027
	<u>1,117,227</u>	<u>-0-</u>	<u>-0-</u>	<u>1,117,227</u>

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	Level 1	Level 2	Level 3	Total
Mutual funds				
Large cap	23,510,426	-0-	-0-	23,510,426
Mid cap	12,507,884	-0-	-0-	12,507,884
Small cap	2,647,241	-0-	-0-	2,647,241
Foreign small	2,305,354	-0-	-0-	2,305,354
Foreign large	8,248,098	-0-	-0-	8,248,098
World stock	3,985,343	-0-	-0-	3,985,343
Diversified emerging markets	1,587,300	-0-	-0-	1,587,300
Intermediate term bond	3,850,872	-0-	-0-	3,850,872
Short term bond	223,403	-0-	-0-	223,403
Real estate	24,313	-0-	-0-	24,313
High yield bond	337,795	-0-	-0-	337,795
Government	3,188,545	-0-	-0-	3,188,545
Bank loan	9,443	-0-	-0-	9,443
Preferred stock	13,443	-0-	-0-	13,443
Inflation protected bond	328,741	-0-	-0-	328,741
	62,768,201	-0-	-0-	62,768,201
Money market mutual funds	-0-	4,692,955	-0-	4,692,955
Perpetual trust, held by trustee	-0-	-0-	310,215	310,215
Fixed income investments				
Brokered certificates of deposit	-0-	149,288	-0-	149,288
Corporate bonds	-0-	36,577	-0-	36,577
Fixed income guaranteed option	-0-	193,448	-0-	193,448
Total fixed income investments	-0-	379,313	-0-	379,313
Total assets at fair value	\$ 63,885,428	\$ 5,072,268	\$ 310,215	69,267,911
Cash and cash equivalents				138,209,646
Certificates of deposit				17,003,892
Interest receivable				19,687
Total deposits and investments				\$ 224,501,136
<u>Liabilities</u>				
Deferred compensation liabilities	\$ -0-	\$ (8,159,682)	\$ -0-	\$ (8,159,682)

The Medical Center's policy is to recognize transfers between levels as of the end of the reporting period. There were no significant transfers between levels 1, 2, and 3 during 2017 and 2016.

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The following summary sets forth a summary of changes in the fair values of the Medical Center's Level 3 assets for the years ended December 31, 2017 and 2016:

	2017	2016
	Perpetual Trust Held by Trustee	Perpetual Trust Held by Trustee
Balance, beginning of the year	\$ 310,215	\$ 308,534
Purchase of investments	-0-	-0-
Redemption	-0-	-0-
Change in investment value	28,826	1,681
Balance, end of year	<u>\$ 339,041</u>	<u>\$ 310,215</u>

**3. PATIENT ACCOUNTS RECEIVABLE**

Patient accounts receivable reported as current assets at December 31, 2017 and 2016, consist of the following:

	2017	2016
Medicare	\$ 22,415,249	\$ 20,763,583
Medicaid	17,666,658	15,461,994
Blue Cross	7,776,988	6,420,287
Other insurance carriers	11,952,991	12,912,219
Patients	24,064,223	23,952,148
Total patient accounts receivable	<u>83,876,109</u>	<u>79,510,231</u>
Less allowance for contractals	26,770,790	24,106,288
Less allowance for uncollectible amounts	<u>28,671,204</u>	<u>26,829,458</u>
Patient accounts receivable, net	<u>\$ 28,434,115</u>	<u>\$ 28,574,485</u>

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**4. ASSETS WHOSE USE IS LIMITED**

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. Assets whose use is limited are reported at market value and include the following at December 31, 2017 and 2016:

**Investment Summary by Type**

	2017	2016
Cash and cash equivalents	\$ 76,171,043	\$ 69,113,474
Money market funds	7,787,928	4,692,955
Interest receivable	39,826	19,687
Certificates of deposit	6,000,000	9,003,892
Brokered certificates of deposit	162,049	149,288
Corporate bonds	16,243	36,577
Common stocks	1,042,750	911,340
Fixed income guaranteed option	71,161	193,448
Mutual funds	76,153,561	62,562,315
Perpetual trust, held by trustee	339,041	310,215
	<hr/>	<hr/>
Total assets whose use is limited	\$ 167,783,602	\$ 146,993,191
Less amount required for current obligations	<hr/> 1,868,822	<hr/> 1,826,227
Assets whose use is limited, net of amount required to meet current obligations	<hr/> <hr/> \$ 165,914,780	<hr/> <hr/> \$ 145,166,964

**Investment Summary by Fund**

Board-Designated Funds	\$ 152,808,967	\$ 133,738,721
Trustee-Held Funds	3,142,373	3,102,106
Donor-Restricted Funds	2,180,012	1,992,682
Deferred Compensation Funds	9,652,250	8,159,682
	<hr/>	<hr/>
Total	<hr/> <hr/> \$ 167,783,602	<hr/> <hr/> \$ 146,993,191

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Board-Designated Funds

The Hospital's Board of Trustees approved the funding of depreciation expense to meet the capital asset replacement needs of the facility. Depreciation is funded totally with expenditures for capital items reducing the funded depreciation balance. Board-designated funds also include amounts intended for specific purposes, as established by the Hospital's, HDC's, and Foundation's separate Boards. All income earned by the board-designated accounts is left to accumulate as additions to the funds. Board-designated funds remain under the control of the separate Boards, which may at their discretion later use for other purposes. Therefore, all board-designated funds are included in unrestricted net position.

Trustee-Held Funds

The trustee-held funds are restricted for the payments of principal and interest related to certain long-term debt agreements.

Donor-Restricted Funds

Donor-restricted funds represent donations that have been restricted by donors for specific purposes.

Deferred Compensation Funds

The deferred compensation funds represent assets that have accumulated under the Medical Center's deferred compensation plan. The Medical Center simply maintains the funds for the participants until they are withdrawn. The Medical Center records a liability equal to the deferred compensation assets.

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**5. CAPITAL ASSETS**

Capital asset activity for the years ended December 31, 2017 and 2016, was as follows:

	2017			
	Beginning Balance	Additions	Retirements/ Transfers	Ending Balance
Land	\$ 8,154,801	\$ -0-	\$ 434,172	\$ 8,588,973
Land improvements	4,281,836	233,777	17,554	4,533,167
Leasehold improvements	671,058	-0-	195,891	866,949
Buildings	87,948,639	812,779	4,995,839	93,757,257
Fixed equipment	5,393,146	174,296	(189,244)	5,378,198
Movable equipment	50,780,300	3,432,540	(1,040,914)	53,171,926
Construction in progress	4,522,214	9,567,341	(8,524,131)	5,565,424
Total historical cost	161,751,994	14,220,733	(4,110,833)	171,861,894
Less accumulated depreciation for				
Land improvements	(2,542,922)	(175,100)	12,407	(2,705,615)
Leasehold improvements	(649,094)	-0-	(23,928)	(673,022)
Buildings	(39,621,276)	(3,949,387)	267,073	(43,303,590)
Fixed equipment	(4,168,144)	(207,477)	64,107	(4,311,514)
Movable equipment	(39,559,066)	(3,748,300)	3,510,876	(39,796,490)
Total accumulated depreciation	<u>(86,540,502)</u>	<u>(8,080,264)</u>	<u>3,830,535</u>	<u>(90,790,231)</u>
Capital assets, net	<u>\$ 75,211,492</u>	<u>\$ 6,140,469</u>	<u>\$ (280,298)</u>	<u>\$ 81,071,663</u>
	2016			
	Beginning Balance	Additions	Retirements/ Transfers	Ending Balance
Land	\$ 7,764,361	\$ 20,754	\$ 369,686	\$ 8,154,801
Land improvements	4,383,253	5,400	(106,817)	4,281,836
Leasehold improvements	671,058	-0-	-0-	671,058
Buildings	86,982,502	314,647	651,490	87,948,639
Fixed equipment	6,456,282	127,142	(1,190,278)	5,393,146
Movable equipment	52,729,417	3,189,632	(5,138,749)	50,780,300
Construction in progress	1,147,873	6,483,761	(3,109,420)	4,522,214
Total historical cost	160,134,746	10,141,336	(8,524,088)	161,751,994
Less accumulated depreciation for				
Land improvements	(2,435,984)	(223,911)	116,973	(2,542,922)
Leasehold improvements	(595,347)	-0-	(53,747)	(649,094)
Buildings	(37,307,302)	(3,879,502)	1,565,528	(39,621,276)
Fixed equipment	(5,159,228)	(202,389)	1,193,473	(4,168,144)
Movable equipment	(40,900,997)	(3,974,338)	5,316,269	(39,559,066)
Total accumulated depreciation	<u>(86,398,858)</u>	<u>(8,280,140)</u>	<u>8,138,496</u>	<u>(86,540,502)</u>
Capital assets, net	<u>\$ 73,735,888</u>	<u>\$ 1,861,196</u>	<u>\$ (385,592)</u>	<u>\$ 75,211,492</u>

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Long-Lived Asset Impairment

The Medical Center evaluates the recoverability of the carrying value of long-lived assets on an ongoing basis and recognizes any impairment in the year of determination. It is reasonably possible that relevant conditions could change in the near term and necessitate a change in management's estimate of the recoverability of these assets. No asset impairment was recognized during the years ended December 31, 2017 and 2016.

**6. OTHER ASSETS**

At December 31, 2017 and 2016, other assets consist of the following:

	2017	2016
Physician notes receivable	\$ 1,406,357	\$ 1,195,124
Notes receivable	16,173	19,115
Investment in managed care company	4,291,957	3,679,293
Investment in RCG Columbus, LLC	974,900	974,900
Investment in captive insurance company	335,311	335,311
Captive insurance company subscriber savings	1,275,029	872,403
Investment in Inspire Health Partners	373,878	63,770
Other	4,552	7,820
Total other assets	8,678,157	7,147,736
Other assets, current portion	(561,722)	(499,629)
Other assets, net of current portion	\$ 8,116,435	\$ 6,648,107

Physician notes receivable are in varying amounts maturing through 2023. If the physicians meet the period of service requirement, the Medical Center will forgive these notes. If the physicians do not meet the period-of-service requirement, the notes are immediately due in full. Interest rates are prime rate + 1 percent (5.50 percent at December 31, 2017).

The Medical Center is a partial owner of a healthcare managed care company. The Medical Center owns 250 shares out of 1,000 for 25 percent ownership and accounts for its investment using the equity method.

The Medical Center made a \$974,900 contribution to purchase a 12.25 percent ownership interest in RCG Columbus, LLC ("RCG"). RCG provides renal care to patients. The Medical Center's investment in RCG is being accounted for under the cost method.

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The Medical Center is a 7.1 percent owner of Tecumseh Health Reciprocal Risk Retention Group (the "Captive"), a risk retention company created to purchase professional liability and general liability insurance for its members. The Medical Center accounts for this investment using the cost method. In addition, the Captive retains a subscriber savings account for each of its members based upon the premiums paid in and the resulting claims paid out, plus other factors. Members are paid the balance of their subscriber savings account once they leave the Captive in accordance with the terms of the Captive agreement.

The Medical Center is a 50 percent owner of Inspire Health Partners ("Inspire"), which is a clinically integrated network of physicians and healthcare providers who work together to coordinate patient care. Inspire is a collaboration between various hospitals, physicians, and the Medical Center to offer a community-based provider network that ensures patients get the right care, at the right time, in the right setting, in the most cost-effective manner. The Medical Center does not have majority voting rights or control over Inspire. The Medical Center accounts for this investment using the equity method.

Separate financial statements related to the joint ventures described above may be obtained by contacting Medical Center management.

**7. COMPENSATED ABSENCES**

The Medical Center provides a paid time off (PTO) policy to employees for vacation, sick time, personal days, and holidays. Upon employment, full and part-time employees who are budgeted, scheduled, and work at least 37.5 hours per pay period accrue PTO from the date of hire. After completion of 6 months of service as a benefit eligible employee, PTO may be used with pay for the total amount accrued.

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The rate at which full-time employees earn PTO and the maximum number of hours that may be banked are as follows:

Employee Type	Length of Service	PTO earned for each hour paid	Maximum PTO bank
Non-exempt	0 - 2 years	0.0885	368 hours
Non-exempt	2 - 10 years	0.1077	448 hours
Non-exempt	10 or more years	0.1270	528 hours
Exempt	0 - 2 years	0.0885	368 hours
Exempt	2 - 5 years	0.1077	448 hours
Exempt	5 or more years	0.1270	528 hours
Vice Presidents	Upon hire	0.1462	608 hours

PTO days are accrued when incurred. The PTO accrual at December 31, 2017 and 2016 was \$4,940,112 and \$4,509,795, respectively and is reported in accrued personnel costs on the consolidated financial statements.

**8. EMPLOYEE HEALTH BENEFIT PLAN**

The Medical Center operates a self-funded health plan covering substantially all employees. The Medical Center has an annual stop loss limit on the plan of \$100,000 per insured per year and an aggregate stop loss limit of approximately \$8,500,000. 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. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of pay out, and other economic and social factors. The accrued liability for claims liabilities is recorded in accrued personnel costs on the consolidated balance sheets.

Changes in the balance of claims liabilities during the years ended December 31, 2017 and 2016, were as follows:

	2017	2016
Accrued liability, beginning of year	\$ 1,086,278	\$ 1,203,381
Incurred claims, changes in estimates, and fees/premiums	10,549,003	7,972,548
Claim payments	(10,154,616)	(8,089,651)
Accrued liability, end of year	<u>\$ 1,480,665</u>	<u>\$ 1,086,278</u>

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**9. DEFINED BENEFIT PENSION PLAN**

Plan Description

The Medical Center sponsors a single-employer, defined benefit pension plan established to provide retirement, termination/severance, disability, and survivor benefits for Medical Center employees. The Plan was established on May 1, 1975 and was last restated effective May 1, 2013. Benefit provisions are established or may be amended at any time by the action of the Plan's Board of Trustees. The Medical Center functions as the plan administrator of the defined benefit pension plan, as authorized by IC 16-22-3-11. A publicly available financial report that includes the defined benefit pension plan's financial statements and required supplementary information may be obtained by contacting:

Schneck Medical Center  
P.O. Box 2349  
Seymour, IN 47274  
Ph. (812) 522-0118

Benefits Provided

The Plan provides that the monthly retirement benefit shall be a pension payable for the member's lifetime equal to one percent (1.00%) of the member's monthly plan compensation, plus sixty-five hundredths of one percent (0.65%) in excess of covered compensation. This sum is then multiplied by the years of benefit service up to thirty (30) years to arrive at the benefit amount. Benefit service is not credited prior to May 1, 1970. The accrued benefit shall not be less than the benefit accrued as of April 30, 1990.

Employees became eligible members of the Plan after one year of service and age twenty-one. Participants are fully vested after 5 years of service. Participation and the accrual of benefits for additional years of service for active participants was frozen as of July 1, 2010.

The employee normal retirement date is age 65 if the employee's date of participation is prior to May 1, 1990, or the later of age 65 or 5 years of service if the employee's date of participation is on or after May 1, 1990. The employee early retirement date can occur once an employee has attained age 55 and has 10 years of service. A reduced early retirement benefit is available to members with at least ten years of vesting service any time after attainment of age 55, with a reduction factor determined by the date of severance from employment.

For participants who severed employment prior to May 1, 2002, the accrued benefit is reduced one-one hundred eightieth (1/180) for each completed month of the first five years and one-three hundred sixtieth (1/360) for each completed month of the next five years by which the date of commencement precedes the normal retirement date. For participants who severed employment on or after May 1, 2002, the accrued benefit is reduced three percent for each year by which the date of commencement precedes the normal retirement date.

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A terminated participant is eligible for termination benefits after five or more years of service with an hour of service after May 1, 2000. A disabled participant is eligible for disability retirement after five or more years of service with an hour of service after May 1, 2000.

The employee's death benefit is payable to a surviving spouse after the satisfaction of early retirements and prior to actual or normal retirement. If a participant's death occurs while an employee on or after satisfaction of early retirement requirements and prior to the earlier of their termination of employment or late retirement, their surviving spouse, if any, will be entitled to a fifty percent survivor benefit. If a participant's death occurs on or after their actual retirement while an employee, but prior to the commencement of their retirement benefit their beneficiary will be entitled to the benefit if any, payable on account of the participant's death, assuming their retirement benefit had commenced the day before their death.

Funding Policy

No contributions from active plan members are required or permitted. The Internal Revenue Service has determined that the plan is a government plan which is not subject to Employee Retirement Income Security Act (ERISA) minimum funding requirements.

Employees Covered by Benefit Terms

At April 30, 2016, the following employees were covered by the benefit terms:

	<u>2017</u>
Inactive plan members or beneficiaries currently receiving benefits	250
Inactive plan members or beneficiaries entitled to but not yet receiving benefits	137
Active plan members	<u>407</u>
Total	<u><u>794</u></u>

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Contributions

The annual required contributions for the year ended April 30, 2017 and estimated liabilities as of May 1, 2017 were determined as part of the actuarial valuations using the Entry Age actuarial cost method. The Medical Center intends to contribute to the Plan each year such amounts as may be required to operate the Plan on a sound actuarial basis.

Net Pension (Asset) Liability

The total pension liability was measured as of May 1, 2017, and the total pension liability used to calculate the net pension (asset) liability was determined by an actuarial valuation as of that date.

*Actuarial Assumptions*

The total pension liability in the May 1, 2017 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

	<u>2017</u>
Inflation	2.50%
Salary increases	Not applicable (Plan is frozen)
Investment rate of return	8%

Mortality rates were based on the 2017 IRS Separate Non-annuitant and Annuitant Mortality Tables (separate Male and Female Tables) with no future assumed mortality improvement.

The actuarial value of assets was determined using the Market Value method and the trust information furnished by PNC Institutional Investments as of April 30, 2017.

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The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Cash	-0- %	0.0%
Fixed income securities	5	2.0%
Domestic and foreign equities	95	5.5%
Total	<u>100 %</u>	

*Discount Rate*

The discount rate used to measure the total pension liability was 8 percent as of April 30, 2017, and is equal to the long-term expected return on plan investments. The projection cash flows used to determine the discount rate assumed that employer contributions would be made at the actuarially calculated rate computed to prevent the deterioration in the actuarial status of the trust. The future contribution assumption was based upon the review of recent Medical Center contribution history compared to the corresponding actuarially determined contributions. Based on this assumption, the Plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members.

*Sensitivity of the Net Pension (Asset) Liability*

The following presents the net pension (asset) liability of the Plan, calculated using the discount rate of 8 percent, as well as what the Plan's net pension (asset) liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7 percent) or 1-percentage-point higher (9 percent) than the current rate:

	1 % Decrease (7.0%)	Current Discount Rate (8.0%)	1% Increase (9.0%)
Net pension (asset) liability	\$ (6,353,196)	\$ (9,351,628)	\$ (11,876,609)

Detailed information about the Plan's fiduciary net position is available in a separately issued actuarial valuation report.

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*Changes in the Net Pension (Asset) Liability*

The change in the net pension (asset) liability during the 2017 Plan year was as follows:

	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension (Asset) Liability (a) - (b)
<b>Balances at 4/30/2016</b>	\$ 27,548,908	\$ 33,401,732	\$ (5,852,824)
<b>Changes of the year:</b>			
Service cost	-0-	-0-	-0-
Interest	2,127,933	-0-	2,127,933
Difference between expected and actual experience	(110,540)	-0-	(110,540)
Change in assumptions	40,006	-0-	40,006
Benefit payments	(1,727,210)	(1,727,210)	-0-
Employer contributions	-0-	-0-	-0-
Net investment income	-0-	5,660,569	(5,660,569)
Administrative expenses	-0-	(104,316)	104,316
Other	-0-	(50)	50
<b>Net changes</b>	330,189	3,828,993	(3,498,804)
<b>Balances at 4/30/2017</b>	\$ 27,879,097	\$ 37,230,725	\$ (9,351,628)

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the year ended December 31, 2017, the Medical Center recognized pension expense (gain) of \$(252,144). At December 31, 2017, the Medical Center reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Balance, 4/30/2016	\$ 4,196,697	\$ (386,751)
Changes in assumptions	22,594	-0-
Liability experience gains (losses)	(31,492)	(54,599)
Investment gains (losses)	(987,622)	(2,195,541)
Balance, 4/30/2017	\$ 3,200,177	\$ (2,636,891)

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Amounts reported as deferred outflows of resources and deferred inflows of resources related to pension will be recognized in pension expense as follows:

Year ended April 30:	Amount
2018	\$ 354,821
2019	354,820
2020	416,324
2021	(571,298)
2022	16,970
Thereafter	(8,351)
	\$ 563,286

**10. LONG-TERM DEBT**

At December 31, 2017 and 2016, the Medical Center was obligated for long-term debt agreements as follows:

	2017	2016
<p>Indiana Financing Authority Series 2010 Revenue Bonds dated December 2010, payable in annual principal installments commencing February 2011 through February 2022, in amounts ranging from \$325,000 to \$1,765,000. Serial fixed interest rates ranging from 3.0% to 5.0%. Secured by gross revenues.</p>	\$ 8,075,000	\$ 9,530,000
<p>IHEFFA Series 2006B Revenue Bonds dated May 2006, payable in annual principal installments commencing February 2007 through February 2036 in amounts ranging from \$150,000 to \$950,000. In May 2013, bonds were converted to long-mode and issued to Capital One Public Funding, LLC and Jackson County Bank who will hold the bonds through February 2023 at which time a balloon payment is due for all remaining unpaid principal and interest. In February 2023, Capital One and Jackson County Bank may exercise a put option on the bonds, or refinance the remaining principal with the Medical Center. Fixed interest rate of 2.8% on \$18,795,000. Secured by gross revenues.</p>	18,345,000	18,495,000
	26,420,000	28,025,000

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Unamortized bond premium	107,599	133,950
Less current portion	<u>(1,701,351)</u>	<u>(1,631,351)</u>
Long-term debt, net of current portion	<u>\$ 24,826,248</u>	<u>\$ 26,527,599</u>

Long-term debt activity for the years ended December 31, 2017 and 2016 was as follows:

	2017				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Revenue bonds, series 2006B	\$ 18,495,000	\$ -0-	\$ (150,000)	\$ 18,345,000	\$ 150,000
Revenue bonds, series 2010	9,530,000	-0-	(1,455,000)	8,075,000	1,525,000
Bond premiums	133,950	-0-	(26,351)	107,599	26,351
<b>Total long-term debt</b>	<b>\$ 28,158,950</b>	<b>\$ -0-</b>	<b>\$ (1,631,351)</b>	<b>\$ 26,527,599</b>	<b>\$ 1,701,351</b>

	2016				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Revenue bonds, series 2006A	\$ 4,500,000	\$ -0-	\$ (4,500,000)	\$ -0-	\$ -0-
Revenue bonds, series 2006B	18,645,000	-0-	(150,000)	18,495,000	150,000
Revenue bonds, series 2010	10,915,000	-0-	(1,385,000)	9,530,000	1,455,000
Bond premiums	207,133	-0-	(73,183)	133,950	26,351
<b>Total long-term debt</b>	<b>\$ 34,267,133</b>	<b>\$ -0-</b>	<b>\$ (6,108,183)</b>	<b>\$ 28,158,950</b>	<b>\$ 1,631,351</b>

Debt service requirements on long-term debt at December 31, 2017 are based on the interest rate modes in effect and are as follows:

Year Ending December 31,	Principal	Interest
2018	\$ 1,701,351	\$ 912,685
2019	1,781,351	832,235
2020	1,856,351	750,810
2021	1,941,351	664,310
2022	1,652,195	571,860
2023 - 2027	17,595,000	492,660
<b>Total</b>	<b>\$ 26,527,599</b>	<b>\$ 4,224,560</b>

The Medical Center's debt agreements contain various restrictive covenants, including covenants related to days cash on hand ratio, debt service coverage ratio, debt to capitalization ratio, and audited financial statement submission requirements. Management believes the Medical Center was in compliance with all restrictive covenants during 2017 and 2016.

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**11. DEFERRED COMPENSATION PLAN**

The Medical Center offers its employees deferred compensation plans in accordance with Internal Revenue Code Sections 457 and 403(b). The plans, available to all Medical Center employees, permit them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plans, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the Medical Center (without being restricted to the provisions of benefits under the plans), subject only to the claims of the Medical Center's general creditors. Participants' rights under the plans are equal to those of general creditors of the Medical Center in an amount equal to the fair market value of the deferred account for each participant. The Medical Center believes that it is unlikely that it will use the assets to satisfy the claims of general creditors in the future. The deferred compensation assets and related liabilities under these plans are reported in the consolidated balance sheets as assets whose use is limited and deferred compensation liabilities, respectively. The amounts recognized as both deferred compensation assets and liabilities were \$9,652,250 and \$8,159,682 for the years ended December 31, 2017 and 2016, respectively.

In 2010, the Medical Center amended its 403(b) defined contribution plan to allow for employer discretionary and matching contributions. For the years ended December 31, 2017 and 2016, the Medical Center recognized \$1,389,668 and \$1,357,718, respectively, in expense related to the 403(b) plan.

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**12. DONOR-RESTRICTED AND NONEXPENDABLE RESTRICTED NET POSITION**

Donor-restricted net position amounts are donor-restricted for a specific use or by the passage of time. Nonexpendable restricted net position amounts include a perpetual trust. Donor-restricted and nonexpendable restricted net position amounts include the following at December 31, 2017 and 2016:

	2017	2016
<b>Donor-restricted net position</b>		
Dr. Bud Fund	\$ 572,349	\$ 501,609
Medical Technology Fund	126,023	125,698
Women's Center Fund	3,332	2,950
Cancer Fund	510,292	447,624
Hospice Fund	365,830	325,168
EPIC Fund	259,469	278,034
Employee Humanitarian Fund	3,676	1,384
Total donor-restricted net position	\$ 1,840,971	\$ 1,682,467
<b>Nonexpendable restricted net position</b>		
Perpetual trust, held by trustee	\$ 339,041	\$ 310,215

Dr. Bud Fund

The Dr. Bud Fund was established to provide scholarships to area students seeking to pursue careers in healthcare. Scholarships are awarded based on the recommendations of the Dr. Bud Fund Scholarship Committee.

Medical Technology Fund

The Medical Technology Fund was established to address the rapid changes in medical technology and related increased costs to replace outdated equipment. The assets of the fund are used to purchase medical equipment.

Cancer Fund

The Cancer Fund was established to provide support for the detection/prevention of cancer.

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Hospice Fund

The Hospice Fund was established to support Hospice program and patient needs.

EPIC Fund

The EPIC (Employee Partners Invested in Caring) Fund was established to receive financial support from its members for special projects and programs recommended by those members.

Perpetual Trust, Held by Trustee

The perpetual trust, held by trustee represents a donation that is held in a separate trust account. The donation is to be held in perpetuity. The Medical Center has no control over the investment strategy of the trust, and will not receive any payments from the trust's principal. However, the Medical Center is entitled to receive 20 percent of the trust's net income each year. All of the Medical Center's portion of income earned by this trust is unrestricted and may be used at the Medical Center's Board of Trustee's discretion.

**13. NET PATIENT SERVICE REVENUE**

For the years ended December 31, 2017 and 2016, net patient service revenue was as follows:

	2017	2016
Gross patient service revenue		
Inpatient services	\$ 67,887,904	\$ 68,028,360
Outpatient services	298,902,271	262,919,879
Long-term care services	165,372,202	168,563,360
Total gross patient service revenue	532,162,377	499,511,599
Deductions from revenue		
Contractual allowances	(256,342,537)	(234,047,804)
Charity care	(1,997,840)	(1,869,476)
Bad debts	(17,069,320)	(16,437,849)
Medicaid DSH payments recognized	2,302,552	3,453,828
Nursing homes UPL payments recognized	24,857,697	22,118,103
Total deductions from revenue	(248,249,448)	(226,783,198)
Total net patient service revenue	\$ 283,912,929	\$ 272,728,401

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The Medical Center grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements. The mix of gross revenues and receivables from patients and third-party payors at December 31, 2017 and 2016, was as follows:

	2017		2016	
	Revenues	Receivables	Revenues	Receivables
Medicare	40 %	27 %	38 %	26 %
Medicaid	27	21	28	19
Blue Cross	16	9	14	8
SIHO*	4	2	5	3
Other third-party payors	7	12	8	13
Patients	6	29	7	31
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

\*Southeastern Indiana Health Organization

The Medical Center has agreements with third-party payors that provide for payments at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

- **Medicare.** The Medical Center is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Medical Center is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicare 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 computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. The Hospital's classification of patients under the Medicare program and the appropriateness of their admissions are subject to an independent review by a peer review organization under contract with the Hospital.
- **Medicaid.** The Medical Center is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Medical Center is reimbursed for Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) 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. There is no cost settlement for either of the inpatient or outpatient programs.

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- ***Charity Care.*** The Medical Center provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because the Medical Center does not collect amounts deemed to be charity care, they are not reported as revenue. 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 Medical Center's total operating expenses divided by gross patient service revenue. For the years ended December 31, 2017 and 2016, the Hospital incurred estimated costs of \$999,322 and \$955,537, respectively.
- ***Other.*** The Medical Center has also entered into preferred provider agreements with certain commercial insurance carriers. The basis for payment to the Medical Center under these agreements includes discounts from established charges, fee schedules, as well as inpatient DRG reimbursement methodologies.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigation and/or allegations concerning possible violations of fraud and abuse statutes and/or regulations by health care providers.

The Centers for Medicare and Medicaid Services ("CMS") has been granted authority to suspend payments, in whole or in part, to Medicare providers if CMS possess reliable information on overpayment, fraud, or if willful misrepresentation exists. If CMS suspects payments are being made as the result of fraud or misrepresentation exists, CMS may suspend payment at any time without providing prior notice to the Medical Center. The initial suspensions period is limited to 180 days. However, the payment suspension period can be extended indefinitely if the matter is under investigation by the United States Department of Health, Human Services Office of Inspector General, or the United States Department of Justice. Therefore, the Medical Center is unable to predict if or when it may be subject to a suspension of payments by the Medicare and/or Medicaid programs, the possible length of the suspension period, or the potential cash flow impact of a payment suspension. Any such suspension would adversely impact the Medical Center's financial position, results of operations, and cash flows. The Medical Center believes that it is in compliance with all applicable laws and regulations.

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**14. ELECTRONIC HEALTH RECORDS (EHR) INCENTIVE PAYMENTS**

The Medical Center receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for EHR incentive payments, the Medical Center must meet "meaningful use" criteria that become more stringent over time. The Medical Center 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 on September 30<sup>th</sup>). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the Medical Center's cost reports. The payment calculation is based upon an initial amount as adjusted for discharges, program 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 Medical Center recognizes EHR incentive payments as grant income when there is reasonable assurance that the Medical Center 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 2017 and 2016, the Medical Center recognized approximately \$29,555 and \$610,734, respectively, in EHR incentive payments as grant income using the cliff recognition method. Under the cliff recognition method, the Medical Center records income at the end of EHR reporting period in which compliance is achieved. EHR incentive income is included in other revenue on the consolidated statements of operations and changes in net position. EHR incentive income is recognized 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 Medical Center as prescribed by the program, subject to future audits and may be subject to repayment upon a determination of noncompliance.

**15. HOSPITAL ASSESSMENT FEE**

The purpose of the Hospital Assessment Fee ("HAF") Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share ("DSH") payments for Indiana hospitals as reflected in the hospital assessment fee reported in the consolidated statements of operations and changes in net position. Previously, the State share was funded by government 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 patient and result in increased Medicaid rates. The Medical Center recognized HAF program expense of \$5,216,041 and \$3,027,163 at December 31, 2017 and 2016, respectively. For the years ended December 31, 2017 and 2016, the Medical Center recognized revenue in net patient service revenue totaling \$2,302,552 and \$3,453,828, respectively, relating to the DSH adjustments.

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**16. NONOPERATING REVENUES (EXPENSES)**

For the years ended December 31, 2017 and 2016, nonoperating revenues (expenses) were as follows:

	2017	2016
Investment income (loss)	\$ 12,045,097	\$ 4,070,939
Interest expense	(754,221)	(1,049,118)
Gain (loss) on disposal of capital assets	(70,937)	(79,242)
Donations	(314,261)	(170,844)
Contributions and grants	1,014,766	747,405
Change in perpetual trust	28,826	1,681
Inspire, gain (loss)	310,108	(47,817)
Miscellaneous	(56,998)	(46,716)
Total nonoperating revenues (expenses)	\$ 12,202,380	\$ 3,426,288

GASB requires interest expense to be reported as nonoperating expense while Financial Accounting Standards Board ("FASB") requires interest expense to be reported as an operating expense.

**17. PROFESSIONAL LIABILITY INSURANCE**

The Indiana Medical Malpractice Act, IC 34-18, provides a maximum recovery of \$250,000 for an occurrence of malpractice and \$1,250,000 for an injury or death of a patient due to an act of malpractice. The Act requires physicians to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$750,000 in the annual aggregate and hospitals to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$5,000,000 for hospitals with fewer than 100 occupied beds. The Act also requires the Medical Center to pay a surcharge to the State Patient's Compensation Fund. This fund may be used to pay medical malpractice claims in excess of the annual aggregate amount noted above, under certain terms and conditions.

The Medical Center maintains professional liability insurance through a multiprovider reciprocal risk retention group (the "Group"), in which premiums are accrued based on the Group's experience to date. This provides protection from liability in amounts not to exceed as follows:

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	2017	2016
Medical Center per occurrence	\$ 250,000	\$ 250,000
Medical Center aggregate	\$ 5,000,000	\$ 5,000,000
Group umbrella aggregate	\$ 10,000,000	\$ 10,000,000
Group first additional umbrella aggregate	10,000,000	10,000,000
Group second additional umbrella aggregate	10,000,000	10,000,000
Total Group umbrella aggregate	\$ 30,000,000	\$ 30,000,000

Liabilities for incurred but not reported losses at December 31, 2017 and 2016 are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Medical Center's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Medical Center intends to continue carrying such insurance.

**18. RELATED PARTY TRANSACTIONS**

Jackson County Bank

The Medical Center's President and Chief Executive Officer serves as a member of the Board of Directors for Jackson County Bank ("JCB"). At December 31, 2017 and 2016, and for the years then ended, the Medical Center had the following related party transactions with JCB:

	2017	2016
Deposits	\$ 56,748,314	\$ 51,043,449
Bonds payable	\$ 2,925,012	\$ 2,925,000
Interest income	\$ 225,993	\$ 120,833
Interest expense	\$ 81,403	\$ 82,017

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Southeastern Indiana Health Organization (SIHO)

The Medical Center is a 25 percent owner of the SIHO insurance company. At December 31, 2017 and 2016, and for the years then ended, the Medical Center had the following related party transactions with SIHO:

Patient accounts receivable	\$ 2,638,257	\$ 2,647,580
Gross patient revenue	\$ 20,826,476	\$ 25,607,060
Operating expenses	\$ 12,770,011	\$ 10,403,935

**19. CONCENTRATIONS OF CREDIT RISK**

The Medical Center maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Medical Center has not experienced any losses on such accounts. The Medical Center believes it is not exposed to any significant credit risk on cash.

**20. OPERATING LEASES**

The Medical Center leases certain building space and equipment under noncancelable operating leases expiring in various years through 2020. Minimum future rental payments under these noncancelable operating leases, as of December 31, 2017, are as follows:

Year Ending December 31,	<u>Amount</u>
2018	\$ 365,580
2019	<u>108,147</u>
Total minimum payments	<u>\$ 473,727</u>

The Medical Center incurred \$20,551,628 and \$19,842,007 in total rent expense for the years ended December 31, 2017 and 2016, respectively, under cancelable and noncancelable operating leases.

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**21. CONTINGENCIES**

The Medical Center is susceptible to a variety of legal proceedings and claims by others against the Medical Center in a variety of matters arising out of the conduct of the Medical Center's business. The ultimate resolution of such claims would not, in the opinion of management, have a material adverse effect on the financial statements.

There may be unknown incidents arising from services provided to patients. However, because the annual insurance policy only covers claims that have been asserted and incidents reported to the insurance carrier, these unknown incidents are not yet covered by insurance. Management intends to maintain the current claims-made insurance coverage to cover any unknown incidents that may be asserted.

HIPAA

Management continues to implement policies, procedures, and a compliance-monitoring organizational structure to enforce and monitor compliance with the Health Insurance Portability and Accountability Act of 1996 ("HIPAA") and other government statutes and regulations. The Medical Center's compliance with such laws and regulations is subject to future government review and interpretations, as well as regulatory actions which are unknown or unasserted at this time.

**22. COMMITMENTS**

As of December 31, 2017, the Medical Center has construction and renovation project commitments as follows:

Project	Expected Date of Completion	Estimated Total Cost of Project	Costs Incurred as of December 31, 2017
Data center	2018	\$ 1,500,000	\$ 1,435,924
MM/Sterile/CSD expansion	2018	2,400,000	1,602,282
MOB and garage	2019	41,670,870	442,755
Elevator 1 and 2 upgrade	2018	350,000	130,000
Pharmacy expansion	2018	363,000	21,600
All other projects	2018	3,145,000	1,932,863
		\$ 49,428,870	\$ 5,565,424

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**23. CONDENSED FINANCIAL INFORMATION**

The Medical Center includes three blended component units in its reporting entity. Condensed component unit information for all of its blended as of and for the year ended December 31, 2017 is as follows:

	HDC	Foundation	JMB	Total
<b>Balance sheet</b>				
Assets				
Current assets	\$ 1,432,726	\$ 930,533	\$ 1,272,604	\$ 3,635,863
Assets whose use is limited	-0-	1,840,971	-0-	1,840,971
Capital assets, net	800,452	-0-	3,159,631	3,960,083
Other assets	726,322	-0-	-0-	726,322
Total assets	2,959,500	2,771,504	4,432,235	10,163,239
Deferred outflows	-0-	-0-	-0-	-0-
Total assets and deferred outflows	\$ 2,959,500	\$ 2,771,504	\$ 4,432,235	\$ 10,163,239
Liabilities				
Current liabilities	\$ 1,537,689	\$ -0-	\$ 1,114	\$ 1,538,803
Long-term liabilities	581,250	-0-	-0-	581,250
Total liabilities	2,118,939	-0-	1,114	2,120,053
Net position				
Net investment in capital assets	800,452	-0-	3,159,631	3,960,083
Restricted expendable	-0-	1,840,971	-0-	1,840,971
Restricted nonexpendable	-0-	-0-	-0-	-0-
Unrestricted	40,109	930,533	1,271,490	2,242,132
Total net position	840,561	2,771,504	4,431,121	8,043,186
Total liabilities and net position	\$ 2,959,500	\$ 2,771,504	\$ 4,432,235	\$ 10,163,239
	HDC	Foundation	JMB	Total
<b>Statement of operations and changes in net position</b>				
Operating revenues				
Net patient service revenue	\$ 2,007,702	\$ -0-	\$ -0-	\$ 2,007,702
Other operating revenue	2,383,146	305,197	785,875	3,474,218
Total operating revenues	4,390,848	305,197	785,875	5,481,920
Operating expenses				
Depreciation and amortization	102,696	-0-	188,084	290,780
Other operating expenses	4,383,687	353,764	409,383	5,146,834
Total operating expenses	4,486,383	353,764	597,467	5,437,614
Income (loss) from operations	(95,535)	(48,567)	188,408	44,306
Non-operating gains (losses)	(55,222)	540,326	-0-	485,104
Change in net position	(150,757)	491,759	188,408	529,410
Net position - beginning of year	991,318	2,279,745	4,242,713	7,513,776
Net position - end of year	\$ 840,561	\$ 2,771,504	\$ 4,431,121	\$ 8,043,186

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	HDC	Foundation	JMB	Total
<b>Statement of cash flows</b>				
Cash provided by				
Operating activities	\$ 588,487	\$ 184,937	\$ 376,043	\$ 1,149,467
Capital and related financing activities	(479,503)	-0-	-0-	(479,503)
Investing activities	(60,443)	(192,805)	-0-	(253,248)
Total	48,541	(7,868)	376,043	416,716
Cash - beginning of year	820,477	191,865	885,529	1,897,871
Cash - end of year	\$ 869,018	\$ 183,997	\$ 1,261,572	\$ 2,314,587

Condensed component unit information for all of its blended components as of and for the year ended December 31, 2016 is as follows:

	HDC	Foundation	JMB	Total
<b>Balance sheet</b>				
Assets				
Current assets	\$ 1,498,829	\$ 607,278	\$ 896,112	\$ 3,002,219
Assets whose use is limited	-0-	1,682,467	-0-	1,682,467
Capital assets, net	423,645	-0-	3,347,715	3,771,360
Other assets	227,258	-0-	-0-	227,258
Total assets	2,149,732	2,289,745	4,243,827	8,683,304
Deferred outflows	-0-	-0-	-0-	-0-
Total assets and deferred outflows	\$ 2,149,732	\$ 2,289,745	\$ 4,243,827	\$ 8,683,304
Liabilities				
Current liabilities	\$ 1,158,414	\$ 10,000	\$ 1,114	\$ 1,169,528
Long-term liabilities	-0-	-0-	-0-	-0-
Total liabilities	1,158,414	10,000	1,114	1,169,528
Net position				
Net investment in capital assets	423,645	-0-	3,347,715	3,771,360
Restricted expendable	-0-	1,682,467	-0-	1,682,467
Restricted nonexpendable	-0-	-0-	-0-	-0-
Unrestricted	567,673	597,278	894,998	2,059,949
Total net position	991,318	2,279,745	4,242,713	7,513,776
Total liabilities and net position	\$ 2,149,732	\$ 2,289,745	\$ 4,243,827	\$ 8,683,304

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	HDC	Foundation	JMB	Total
<b>Statement of operations and changes in net position</b>				
Operating revenues				
Net patient service revenue	\$ 1,811,848	\$ -0-	\$ -0-	\$ 1,811,848
Other operating revenue	1,850,897	319,070	769,828	2,939,795
Total operating revenues	<u>3,662,745</u>	<u>319,070</u>	<u>769,828</u>	<u>4,751,643</u>
Operating expenses				
Depreciation and amortization	130,367	12,318	188,084	330,769
Other operating expenses	4,347,589	370,926	377,226	5,095,741
Total operating expenses	<u>4,477,956</u>	<u>383,244</u>	<u>565,310</u>	<u>5,426,510</u>
Income (loss) from operations	(815,211)	(64,174)	204,518	(674,867)
Non-operating gains (losses)	(560)	(440,974)	-0-	(441,534)
Change in net position	(815,771)	(505,148)	204,518	(1,116,401)
Net position - beginning of year	1,807,089	2,784,893	4,038,195	8,630,177
Net position - end of year	<u>\$ 991,318</u>	<u>\$ 2,279,745</u>	<u>\$ 4,242,713</u>	<u>\$ 7,513,776</u>
	HDC	Foundation	JMB	Total
<b>Statement of cash flows</b>				
Cash provided by				
Operating activities	\$ (485,916)	\$ 142,701	\$ 406,262	\$ 63,047
Noncapital financing activities	-0-	-0-	-0-	-0-
Capital and related financing activities	280,606	-0-	-0-	280,606
Investing activities	(51,350)	(167,937)	-0-	(219,287)
Total	<u>(256,660)</u>	<u>(25,236)</u>	<u>406,262</u>	<u>124,366</u>
Cash - beginning of year	1,077,137	217,101	479,267	1,773,505
Cash - end of year	<u>\$ 820,477</u>	<u>\$ 191,865</u>	<u>\$ 885,529</u>	<u>\$ 1,897,871</u>

**24. RECENT GASB PRONOUNCEMENTS**

Management has not currently determined what effects, if any, the implementation of the following recently enacted statements may have on its future financial statements:

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

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**GASB Statement No. 84**, *Fiduciary Activities*, issued January 2017, will be effective for periods beginning after December 15, 2018. This Statement improves guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. It establishes criteria for identifying activities of all state and local governments, which is generally focused on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private purpose trust funds, and (4) custodial funds. Lastly, this Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

REQUIRED SUPPLEMENTARY INFORMATION

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**SCHEDULE OF CHANGES IN THE MEDICAL CENTER'S NET PENSION (ASSET) LIABILITY  
AND RELATED RATIOS**

	2017	2016	2015
<b>Total pension liability</b>			
Service cost	\$ -0-	\$ -0-	\$ -0-
Interest	2,127,933	2,077,981	2,056,704
Difference between expected and actual experience	(110,540)	216,064	(278,935)
Change in assumptions	40,006	39,514	38,454
Benefit payments	(1,727,210)	(1,654,220)	(1,430,850)
<b>Net change in total pension liability</b>	330,189	679,339	385,373
<b>Total pension liability - beginning</b>	27,548,908	26,869,569	26,484,196
<b>Total pension liability - ending (a)</b>	\$ 27,879,097	\$ 27,548,908	\$ 26,869,569
<b>Plan fiduciary net position</b>			
Employer contributions	\$ -0-	\$ -0-	\$ -0-
Net transfers into (out of) trust	-0-	-0-	-0-
Net investment income	5,660,569	(2,126,387)	3,223,583
Benefit payments	(1,727,210)	(1,654,220)	(1,430,850)
Administrative expenses	(104,316)	(42,455)	(67,884)
Other	(50)	-0-	(37,011)
<b>Net change in plan fiduciary net position</b>	3,828,993	(3,823,062)	1,687,838
<b>Plan fiduciary net position - beginning</b>	33,401,732	37,224,794	35,536,956
<b>Plan fiduciary net position - ending (b)</b>	\$ 37,230,725	\$ 33,401,732	\$ 37,224,794
<b>Medical Center net pension (asset) liability - ending (a) - (b)</b>	\$ (9,351,628)	\$ (5,852,824)	\$ (10,355,225)
<b>Plan fiduciary net position as a percentage of the total net pension liability</b>	133.54%	121.25%	138.54%
<b>Covered payroll</b>	N/A	N/A	N/A
<b>Medical Center net pension (asset) liability as a percentage of covered payroll</b>	N/A	N/A	N/A

\*The schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the Medical Center will present information for those years for which information is available.

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**SCHEDULE OF MEDICAL CENTER CONTRIBUTIONS**

	Actuarially determined contribution	Employer contributions	Contribution deficiency (excess)	Covered payroll	Contributions as a % of covered payroll
4/30/2017	\$ -0-	\$ -0-	\$ -0-	N/A	N/A
4/30/2016	-0-	-0-	-0-	N/A	N/A
4/30/2015	-0-	-0-	-0-	N/A	N/A
4/30/2014	-0-	-0-	-0-	N/A	N/A
4/30/2013	-0-	-0-	-0-	N/A	N/A
4/30/2012	-0-	-0-	-0-	N/A	N/A
4/30/2011	-0-	-0-	-0-	N/A	N/A

**Notes to Schedule**

Valuation date: Actuarially determined contribution rates are calculated as of May 1, one year prior to the end of the fiscal year in which contributions are reported.

Methods and assumptions used to determine most current contribution rate above:

Actuarial cost method	Entry Age
Amortization method	Level dollar, open
Remaining amortization method	30 years
Asset valuation method	Market value
Inflation	2.50%
Salary increases	Not applicable (Plan is frozen)
Investment rate of return	8.00%
Retirement age	65
Mortality	2017 IRS Annuitant/Non-Annuitant Mortality Tables (sex-distinct) with no mortality improvement