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June 8, 2018

Board of Trustees
Hancock Regional Hospital
801 N. State Street
Greenfield, IN 46140

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 Hancock Regional Hospital 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.

A handwritten signature in blue ink that reads "Paul D. Joyce".

Paul D. Joyce, CPA
State Examiner



COMBINED FINANCIAL STATEMENTS

DECEMBER 31, 2017 AND 2016



HANCOCK REGIONAL HOSPITAL

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Hancock Regional Hospital
Greenfield, Indiana

Report on the Combined Financial Statements

We have audited the accompanying combined financial statements of Hancock Regional Hospital and component units (the "Hospital"), a component unit of Hancock County, which comprise the combined balance sheets as of December 31, 2017 and 2016, and the related combined statements of operations and changes in net position, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined financial statements.

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

Board of Trustees
Hancock Regional Hospital
Greenfield, Indiana

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined 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 combined 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 combined financial statements, and other knowledge we obtained during our audits of the basic combined financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Blue & Co., LLC

Indianapolis, Indiana
May 23, 2018

REQUIRED SUPPLEMENTARY INFORMATION

HANCOCK REGIONAL HOSPITAL

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

This section of Hancock Regional Hospital's (Hospital) annual combined financial statements presents background information and management's discussion and analysis of the Hospital's financial performance during the years ended December 31, 2017 and 2016. Please read it in conjunction with the Hospital's combined financial statements, which begin on page 3. Unless otherwise indicated, amounts are in thousands and are approximates.

FINANCIAL HIGHLIGHTS

- The Hospital reported an increase in net position of approximately \$38,588 or 19% for the year ended 2017.
- Operating income in 2017 compared to 2016 increased by \$7,364 or 29%.
- Nonoperating income increased from 2017 to 2016 by \$1,180 or 20%.

USING THIS ANNUAL REPORT

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

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

Our analysis of the Hospital finances begins on page ii. One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Operations and Changes in Net Position report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

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

HANCOCK REGIONAL HOSPITAL

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

THE STATEMENT OF CASH FLOWS

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?"

THE HOSPITAL'S NET POSITION

The Hospital's net position is the difference between its assets and liabilities reported in the Balance Sheet on page 3. The Hospital's net position increased in 2017 by \$38,588 (19%) as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Position

	2017	2016	2017 - 2016 \$ Change	2015
Assets				
Current assets	\$ 140,302	\$ 116,630	\$ 23,672	\$ 112,839
Capital assets, net	71,390	79,711	(8,321)	78,025
Restricted and limited use assets	93,841	67,265	26,576	41,709
Other noncurrent assets	12,958	4,763	8,195	4,080
Total assets	<u>318,491</u>	<u>268,369</u>	<u>50,122</u>	<u>236,653</u>
Liabilities				
Current liabilities	<u>79,709</u>	<u>68,175</u>	<u>11,534</u>	<u>66,927</u>
Total liabilities	<u>79,709</u>	<u>68,175</u>	<u>11,534</u>	<u>66,927</u>
Net Position				
Net investment in capital assets	71,390	79,711	(8,321)	78,025
Donor restricted - expendable	6,639	5,196	1,443	4,685
Restricted nonexpendable	2,154	2,344	(190)	2,231
Unrestricted	<u>158,599</u>	<u>112,943</u>	<u>45,656</u>	<u>84,785</u>
Total net position	238,782	200,194	38,588	169,726
Total liabilities and net position	<u>\$ 318,491</u>	<u>\$ 268,369</u>	<u>\$ 50,122</u>	<u>\$ 236,653</u>

HANCOCK REGIONAL HOSPITAL

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

A significant component in the Hospital's assets is the increase in Restricted and Limited Use Assets which increased significantly by \$26,576 or 40% due primarily to funding investments with cash and market performance.

OPERATING RESULTS AND CHANGES IN THE HOSPITAL'S NET POSITION

In 2017, the Hospital's change in net position increased by \$8,120 compared to 2016 as shown in Table 2.

Table 2: Operating Results and Changes in Net Position

			2017 - 2016	
	2017	2016	\$ Change	2015
Operating Revenue				
Net patient service revenue	\$ 476,224	\$ 469,317	\$ 6,907	\$ 429,127
Other	8,965	7,660	1,305	7,711
Total operating revenue	485,189	476,977	8,212	436,838
Operating expenses				
Salaries and benefits	57,907	54,450	3,457	49,047
Medical supplies and drugs	49,046	48,161	885	37,433
Purchased services and medical fees	315,412	321,191	(5,779)	300,316
Depreciation and amortization	10,304	10,228	76	9,214
Hospital assessment fee	3,329	2,164	1,165	2,475
Other operating expense	16,039	14,995	1,044	13,485
Total operating expense	452,037	451,189	848	411,970
Operating income	33,152	25,788	7,364	24,868
Nonoperating income (expense)				
Noncapital contributions	2,019	1,310	709	1,529
Other nonoperating expense	(403)	(958)	555	(739)
Loss on disposal of capital assets	(4,708)	(14)	(4,694)	-0-
Investment income	10,124	5,514	4,610	(2,348)
Total nonoperating income (expense)	7,032	5,852	1,180	(1,558)
Change in net position before capital distributions	40,184	31,640	8,544	23,310
Capital distributions	(1,596)	(1,172)	(424)	(1,168)
Change in net position	38,588	30,468	8,120	22,142
Net position				
Beginning of year	200,194	169,726	30,468	147,584
End of year	\$ 238,782	\$ 200,194	\$ 38,588	\$ 169,726

HANCOCK REGIONAL HOSPITAL

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

SOURCES OF REVENUE

During 2017, the Hospital derived substantially all of its revenue from patient service and other related activities. Revenue includes, among other items, revenue from the Medicare and Medicaid programs, patients, insurance carriers, preferred provider organizations, and managed care programs.

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

	2017	2016	2015
Medicare	52%	53%	56%
Medicaid	11%	10%	6%
Commercial	33%	33%	34%
Self-pay	4%	4%	4%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

The Hospital provides care to patients under payment arrangements with Medicare, Medicaid, and various managed care programs. Services provided under those arrangements are paid at predetermined rates and/or reimbursable costs as defined. Provisions have been made in the combined financial statements for contractual adjustments, which represent the difference between the standard charges for services and the actual or estimated payment. Total operating revenue increased \$8,212 or 2% in 2017 compared to 2016. This increase was primarily the result of an increase in volumes. Disproportionate Share Hospital Payment (DSH) for years 2017 and 2016 were \$2,738 and \$1,826, respectively. The Hospital recognized Electronic Health Record Incentive revenue in 2017 and 2016 of \$-0- and \$292, respectively, by meeting Meaningful Use requirements. This revenue is included in other operating revenue.

OPERATING INCOME

The first component of the overall change in the Hospital's net position is its operating income, generally the difference between net patient service and the expenses incurred to perform those services. In each of the past two years, the Hospital has reported an operating gain. This is consistent with the Hospital's entire operating history. The Hospital's operations were begun in 1951 as a county owned and operated hospital under Indiana Code 16-22.

HANCOCK REGIONAL HOSPITAL

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

The increase in the Hospital's operating income in 2017 of \$7,364 or 29% from 2016 was the result of a rate increase and volume in oncology and other volume increases in 2017. The Hospital increased gross charge rates by 5% for both years ended December 31, 2017 and 2016, respectively. More importantly, as noted previously, the Hospital's volumes increased. Total operating expenses increased \$848 or 1% in 2017 compared to 2016. The increase in operating expenses was the result of salaries and benefits, medical supplies and drugs, and Hospital assessment fees. Salaries and benefits increased due to an increase in full-time equivalents. Medical supplies and drugs increased due to an increase in pharmaceutical costs as well as services provided for oncology services.

The Hospital experienced statistical changes in the following areas:

Statistical Growth	2017	2016	2017 - 2016	2015
			% Increase / <Decrease>	
Patient Days	15,207	15,257	-0.33%	14,965
Diagnostic Imaging Procedures	65,948	60,482	9.04%	60,443
Laboratory Procedures	318,470	309,233	2.99%	323,363
Pharmaceutical Medication Units	431,470	426,792	1.10%	420,137
Rehab Procedures	54,443	65,880	-17.36%	61,104
Home Health Units of Service	49,386	39,840	23.96%	27,162
Outpatient Clinic Procedures	8,250	5,529	49.21%	6,232

Excluded from net patient service revenue are charges for patient service waived under the Hospital's uncompensated care policy. Uncompensated care represents unreimbursed charges, both charity care and bad debt, incurred by the Hospital in providing uncompensated care to patients. Based on established rates, gross charges of \$6,218 were waived during 2017. This is an increase compared to the previous year.

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

NONOPERATING INCOME AND EXPENSES

Nonoperating income and expenses are the result of changes in the Hospital's investment income, loss on disposal of capital assets, and other non-capital grants and contributions. The Hospital's investment income significantly increased primarily due to market conditions during 2017. The Hospital incurred a loss on disposal of capital assets during 2017 due to the sale of capital assets from a long-term care facility to an outside third party. The Hospital's nonoperating income and expenses increased in 2017 by \$1,180 from 2016.

HANCOCK REGIONAL HOSPITAL

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

GRANTS AND CONTRIBUTIONS

The Hospital receives operating grants from various state and federal agencies for specific programs. Operating grants received in 2017 totaled \$977 compared to \$843 in 2016.

Some of the significant grants received by the Hospital are:

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

THE HOSPITAL’S CASH FLOWS

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

Table 3: Statements of Cash Flow

	2017	2016	Change	2015
Net cash flows from				
Operating activities	\$ 46,639	\$ 30,972	\$ 15,667	\$ 34,700
Noncapital financing activities	1,617	351	1,266	790
Capital and related financing	(3,580)	(13,038)	9,458	(22,599)
Investing	(41,148)	(9,473)	(31,675)	6,042
Change in cash and cash equivalents	<u>\$ 3,528</u>	<u>\$ 8,812</u>	<u>\$ (5,284)</u>	<u>\$ 18,933</u>

CAPITAL ASSETS AND DEBT ADMINISTRATION

CAPITAL ASSETS

During 2017, the Hospital’s net capital assets decreased by approximately \$8,321. This compares to an increase of approximately \$1,686 for 2016 compared to 2015. The decrease in 2017 was due to a significant amount of capital asset disposals.

HANCOCK REGIONAL HOSPITAL

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

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

	2017	2016	Change	2015
Land	\$ 718	\$ 1,241	\$ (523)	\$ 1,241
Land improvements	7,803	8,457	(654)	6,845
Building and fixed equipment	121,638	123,267	(1,629)	113,252
Major moveable equipment	83,908	82,953	955	76,966
Construction in progress	1,166	277	889	6,024
Total capital assets	215,233	216,195	(962)	204,328
Less accumulated depreciation	143,843	136,484	7,359	126,303
	<u>\$ 71,390</u>	<u>\$ 79,711</u>	<u>\$ (8,321)</u>	<u>\$ 78,025</u>

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

DEBT

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

CONTACTING THE HOSPITAL'S FINANCIAL MANAGEMENT

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital Chief Financial Officer's Office, 801 N State Street, Greenfield, IN 46140.

HANCOCK REGIONAL HOSPITAL

COMBINED BALANCE SHEETS DECEMBER 31, 2017 AND 2016

ASSETS

	2017	2016
Current assets		
Cash and cash equivalents	\$ 63,727,455	\$ 48,942,906
Investments	1,797,854	1,260,700
Patient accounts receivable, net	48,529,127	42,618,303
Inventories and other current assets	26,247,300	23,808,429
Total current assets	140,301,736	116,630,338
Assets whose use is limited		
Board designated funds	87,202,036	62,069,515
Donor restricted funds	6,638,843	5,195,803
Total assets whose use is limited	93,840,879	67,265,318
Capital assets		
Land and land improvements	8,520,726	9,698,502
Buildings and fixed equipment	121,637,934	123,267,332
Major movable equipment	83,907,538	82,952,827
Construction in progress	1,166,758	276,302
Total capital assets	215,232,956	216,194,963
Less accumulated depreciation	143,842,791	136,484,228
Capital assets, net	71,390,165	79,710,735
Other assets	12,958,316	4,762,784
Total assets	\$ 318,491,096	\$ 268,369,175

See accompanying notes to combined financial statements

HANCOCK REGIONAL HOSPITAL

COMBINED BALANCE SHEETS DECEMBER 31, 2017 AND 2016

LIABILITIES AND NET POSITION

	2017	2016
Current liabilities		
Accounts payable and other liabilities	\$ 69,298,282	\$ 60,035,239
Accrued salaries and related liabilities	5,643,122	4,948,401
Estimated third-party settlements	4,767,435	3,191,808
Total current liabilities	79,708,839	68,175,448
Total liabilities	79,708,839	68,175,448
Net position		
Net investment in capital assets	71,390,165	79,710,735
Donor restricted expendable	6,638,843	5,195,803
Restricted nonexpendable	2,153,951	2,344,144
Unrestricted	158,599,298	112,943,045
Total net position	238,782,257	200,193,727
Total liabilities and net position	\$ 318,491,096	\$ 268,369,175

See accompanying notes to combined financial statements

HANCOCK REGIONAL HOSPITAL

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

	2017	2016
Operating revenue		
Net patient service revenue	\$ 476,223,600	\$ 469,316,873
Other operating revenue	8,965,249	7,660,267
Total operating revenue	485,188,849	476,977,140
Operating expenses		
Salaries and wages	46,833,705	43,224,257
Employee benefits	11,073,360	11,225,878
Professional medical fees	3,054,532	2,457,324
Supplies and drugs	49,046,317	48,160,665
Purchased services	312,357,773	318,733,646
Utilities and insurance	9,960,096	10,114,616
Depreciation and amortization	10,304,464	10,228,366
Hospital assessment fee	3,329,379	2,164,473
Other	6,078,487	4,880,408
Total operating expenses	452,038,113	451,189,633
Operating income	33,150,736	25,787,507
Nonoperating income (expense), net		
Noncapital contributions	2,018,853	1,310,342
Other nonoperating expense	(401,570)	(958,887)
Loss on disposal of capital assets	(4,707,508)	(14,285)
Investment income	10,123,689	5,514,148
Total non-operating income (expense), net	7,033,464	5,851,318
Change in net position before capital distributions	40,184,200	31,638,825
Capital distributions - noncontrolling interest	(1,595,670)	(1,171,726)
Change in net position	38,588,530	30,467,099
Net position		
Beginning of year	200,193,727	169,726,628
End of year	\$ 238,782,257	\$ 200,193,727

See accompanying notes to combined financial statements

HANCOCK REGIONAL HOSPITAL

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

	2017	2016
Operating activities		
Cash received from patients and third party payors	\$ 471,888,403	\$ 465,994,210
Cash paid to employees for wages and benefits	(57,212,344)	(53,879,855)
Cash paid to vendors for goods and services	(377,002,412)	(388,803,106)
Other operating receipts	8,965,249	7,660,267
Net cash from operating activities	46,638,896	30,971,516
Noncapital financing activities		
Noncapital contributions	2,018,853	1,310,342
Other nonoperating	(401,570)	(958,887)
Net cash from noncapital financing activities	1,617,283	351,455
Capital and related financing activities		
Acquisition and construction of capital assets	(8,312,866)	(11,880,993)
Loss on disposal of capital assets	4,707,508	14,285
Proceeds on disposal of capital assets	1,621,464	-0-
Capital distributions - noncontrolling interest	(1,595,670)	(1,171,726)
Net cash from capital and related financing activities	(3,579,564)	(13,038,434)
Investing activities		
Other assets	(8,195,532)	(682,723)
Investment income	10,123,689	5,514,148
Other changes in assets whose use is limited, net	(43,077,130)	(14,303,571)
Net cash from investing activities	(41,148,973)	(9,472,146)
Net change in cash and cash equivalents	3,527,642	8,812,391
Cash and cash equivalents		
Beginning of year	61,425,588	52,613,197
End of year	\$ 64,953,230	\$ 61,425,588

See accompanying notes to combined financial statements

HANCOCK REGIONAL HOSPITAL

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

	2017	2016
Reconciliation of operating income to net cash from operating activities		
Operating income	\$ 33,150,736	\$ 25,787,507
Adjustment to reconcile operating income to net cash from operating activities		
Depreciation and amortization	10,304,464	10,228,366
Bad debts	10,976,962	11,862,680
Changes in assets and liabilities		
Patient accounts receivable	(16,887,786)	(13,187,057)
Other current assets	(2,438,871)	(4,968,668)
Accounts payable and other liabilities	9,263,043	2,676,694
Accrued salaries and related liabilities	694,721	570,280
Estimated third-party settlements	1,575,627	(1,998,286)
Net cash from operating activities	<u>\$ 46,638,896</u>	<u>\$ 30,971,516</u>
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents:		
In current assets	\$ 63,727,455	\$ 48,942,906
In investments and assets whose use is limited	1,225,775	12,482,682
Total cash and cash equivalents	<u>\$ 64,953,230</u>	<u>\$ 61,425,588</u>

See accompanying notes to combined financial statements

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

1. SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

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

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

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

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

Blended Component Units

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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

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

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

Use of Estimates

The preparation of combined financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements.

Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Measurement Focus and Basis of Accounting

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

Cash and Cash Equivalents

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

Patient Accounts Receivable and Net Patient Service Revenue

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

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

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

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

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

These programs have audited the year-end cost report filed with the Medicare program through December 31, 2013. There were no significant differences reflected as deductions from revenue during 2017 and 2016. Amounts for unresolved cost reports for 2014 through 2017 are reflected in estimated third-party settlements on the combined balance sheets.

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

The Medicaid enhanced payments relate to both fee for service and managed care claims. Under the HAF Program, the enhanced Medicaid payments follow the patients and are realized through increased Medicaid rates. During 2017 and 2016, HRH recognized HAF Program expense of approximately \$3,329,000 and \$2,164,000, respectively. The Medicaid rate increases under the HAF Program are included in patient service revenue in the combined statements of operations and changes in net position.

Net revenue from the Medicare and Medicaid programs accounted for approximately 83 percent of the Hospital's net patient revenue for the year ended 2017, and 84 percent of the Hospital's net patient revenue, for the year ended 2016. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

HANCOCK REGIONAL HOSPITAL

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The Hospital recognized revenue related to the Medicaid Disproportionate Share Hospital and the Upper Payment Limitation programs of approximately \$2,700,000 and \$1,800,000 for the years ended December 31, 2017 and 2016, respectively. These amounts are reimbursements for providing care to the uninsured and underinsured and are included in net patient service revenue within the combined statements of operations and changes in net position.

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

Charity Care

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

Of the Hospital's total expenses (excluding subsidiaries and long-term care operations) reported within the combined statements of operations and changes in net position, an estimated \$2,273,000 and \$1,579,000 arose from providing services to charity patients during 2017 and 2016, respectively. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total expenses divided by gross patient service revenue.

Inventories

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

Assets Whose Use is Limited and Investments

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

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Capital Assets and Depreciation

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

The ranges of useful lives in computing depreciation include the following:

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

Costs of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. No amounts were capitalized as of December 31, 2017 and 2016.

Income Taxes

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

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

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Management has analyzed the tax positions taken by the Hospital 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 combined financial statements. The Hospital is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

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

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

Advertising and Community Relations

The Hospital records advertising and promotion expense in the period incurred. Total expense for advertising and promotion was approximately \$748,000 and \$635,000 for 2017 and 2016, respectively.

Compensated Absences

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

Net Position

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

Donor Restricted Net Position

Restricted funds include donations to the Foundation that have been restricted by donors for a specific purpose. Generally, these donations are for additions to Hospital property and equipment.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Transfers are made to unrestricted funds as expenditures are made in accordance with the donor restrictions.

Operating Revenues and Expenses

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

Electronic Health Records (EHR) Incentive Payments

HRH receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for the EHR incentive payments, HRH must meet "meaningful use" criteria that become more stringent over time. HRH periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data.

These submissions generally include performance measures for each annual EHR reporting period (Federal fiscal year ending September 30th). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in HRH's cost reports.

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

HRH recognizes EHR incentive revenues as income when there is reasonable assurance that HRH will comply with the conditions of the meaningful use objectives and any other specific requirements. In addition, the financial statement effects of the income must be both recognizable and measurable. During 2017 and 2016, HRH recognized approximately \$-0- and \$292,000, respectively, in EHR incentive revenue. Under the ratable recognition method, HRH recognizes revenue ratably over the entire EHR reporting period when it is reasonably assured at the outset of the EHR reporting period that it will comply with the minimum requirements of the program.

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

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Contributions

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

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

Restricted Resources

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

Litigation

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

Risk Management

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

Accounting for Noncontrolling Interest

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

Reclassification

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Subsequent Events

The Hospital evaluated events or transactions occurring subsequent to the combined balance sheet date for recognition and disclosure in the accompanying combined financial statements through the date the combined financial statements are available to be issued which is May 23, 2018.

Recently Issued Accounting Standard

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

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

2. INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

Board Designated Funds

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

Donor Restricted Funds

The Hospital has assets, which have been donated for a specific purpose. The following represents assets whose use is limited and investments as of December 31, 2017 and 2016:

	2017	2016
Board designated funds	\$ 87,202,036	\$ 62,069,515
Donor restricted funds	6,638,843	5,195,803
Total assets whose use is limited	93,840,879	67,265,318
Investments	1,797,854	1,260,700
	<u>\$ 95,638,733</u>	<u>\$ 68,526,018</u>

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

The following represents the makeup of assets whose use is limited and investments as of December 31, 2017 and 2016:

	2017	2016
Money market funds	\$ 1,225,775	\$ 12,482,682
Certificates of deposit	350,667	250,041
Common stocks	2,598,924	1,488,420
Mutual funds - equities	58,522,549	34,037,945
Mutual funds - fixed income	32,940,818	20,266,930
	<u>\$ 95,638,733</u>	<u>\$ 68,526,018</u>

The common stocks are held by the Foundation.

3. DEPOSITS AND INVESTMENTS

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

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

The Hospital's investments generally are reported at fair value. As of December 31, 2017 and 2016, the Hospital had the following investments and maturities, all of which were held in the Hospital's name by custodial financial institutions that are agents of the Hospital.

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

December 31, 2016					
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Money market funds	\$ 12,482,682	\$ 12,482,682	\$ -0-	\$ -0-	\$ -0-
Certificates of deposit	250,041	250,041	-0-	-0-	-0-
Common stocks	1,488,420	1,488,420	-0-	-0-	-0-
Mutual funds - equities	34,037,945	34,037,945	-0-	-0-	-0-
Mutual funds - fixed income	20,266,930	20,266,930	-0-	-0-	-0-
	<u>\$ 68,526,018</u>	<u>\$ 68,526,018</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

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

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

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

Deposits and investments consist of the following as of December 31, 2017 and 2016:

	2017	2016
Carrying amount		
Deposits	\$ 63,727,455	\$ 48,942,906
Investments	95,638,733	68,526,018
	<u>\$ 159,366,188</u>	<u>\$ 117,468,924</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 63,727,455	\$ 48,942,906
Investments	1,797,854	1,260,700
Board designated funds	87,202,036	62,069,515
Donor restricted funds	6,638,843	5,195,803
	<u>\$ 159,366,188</u>	<u>\$ 117,468,924</u>

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

4. FAIR VALUE MEASUREMENTS

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

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

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

The Hospital's policy is to recognize transfers between levels as of the end of the reporting period. There were no significant transfers between levels during 2017 and 2016.

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.

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

The following table sets forth by level, within the hierarchy, the Hospital's assets and liabilities measured at fair value on a recurring basis as of December 31, 2017 and 2016.

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Assets				
Investments and assets whose use is limited				
Mutual funds - equities				
Large blend	\$ 22,955,742	\$ 22,955,742	\$ -0-	\$ -0-
Large growth	12,442,796	12,442,796	-0-	-0-
Large value	13,628,730	13,628,730	-0-	-0-
Medium blend	3,539,349	3,539,349	-0-	-0-
Medium growth	438,762	438,762	-0-	-0-
Medium value	455,574	455,574	-0-	-0-
Small blend	354,489	354,489	-0-	-0-
Small growth	349,862	349,862	-0-	-0-
Small value	4,355,830	4,355,830	-0-	-0-
Other (global, commodities, and index)	1,415	1,415	-0-	-0-
Total mutual funds - equities	58,522,549	58,522,549	-0-	-0-
Mutual funds - fixed income				
High yield bond	1,733,686	1,733,686	-0-	-0-
Intermediate term bond	25,821,320	25,821,320	-0-	-0-
Short-term bond	5,385,812	5,385,812	-0-	-0-
Total mutual funds - fixed income	32,940,818	32,940,818	-0-	-0-
Common stocks				
Consumer goods	472,967	472,967	-0-	-0-
Energy	139,145	139,145	-0-	-0-
Financial	272,779	272,779	-0-	-0-
Healthcare	270,392	270,392	-0-	-0-
Industrials	18,562	18,562	-0-	-0-
Real estate	25,761	25,761	-0-	-0-
Services	125,229	125,229	-0-	-0-
Technology	471,516	471,516	-0-	-0-
Utilities	55,899	55,899	-0-	-0-
Other	746,674	746,674	-0-	-0-
Total common stocks	2,598,924	2,598,924	-0-	-0-
Money market funds				
	1,225,775	-0-	1,225,775	-0-
		<u>\$ 91,463,367</u>	<u>\$ 1,225,775</u>	<u>\$ -0-</u>
Certificates of deposit *				
	350,667			
	<u>\$ 95,638,733</u>			

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
Assets				
Investments and assets whose use is limited				
Mutual funds - equities				
Large blend	\$ 11,836,602	\$ 11,836,602	\$ -0-	\$ -0-
Large growth	4,839,908	4,839,908	-0-	-0-
Large value	7,850,757	7,850,757	-0-	-0-
Medium growth	1,603,596	1,603,596	-0-	-0-
Small blend	888,808	888,808	-0-	-0-
Small value	2,293,691	2,293,691	-0-	-0-
Other (global, commodities, and index)	4,724,583	4,724,583	-0-	-0-
Total mutual funds - equities	34,037,945	34,037,945	-0-	-0-
Mutual funds - fixed income				
Intermediate term bond	18,870,107	18,870,107	-0-	-0-
Short-term bond	1,396,823	1,396,823	-0-	-0-
Total mutual funds - fixed income	20,266,930	20,266,930	-0-	-0-
Common stocks				
Consumer goods	410,527	410,527	-0-	-0-
Energy	59,446	59,446	-0-	-0-
Financial	236,999	236,999	-0-	-0-
Healthcare	212,112	212,112	-0-	-0-
Industrials	66,077	66,077	-0-	-0-
Services	79,276	79,276	-0-	-0-
Technology	350,908	350,908	-0-	-0-
Utilities	73,075	73,075	-0-	-0-
Total common stocks	1,488,420	1,488,420	-0-	-0-
Money market fund	12,482,682	-0-	12,482,682	-0-
		<u>\$ 55,793,295</u>	<u>\$ 12,482,682</u>	<u>\$ -0-</u>
Certificates of deposit *	250,041			
	<u>\$ 68,526,018</u>			

* Certificates of deposit are reported at contract value

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

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

5. ACCOUNTS RECEIVABLE AND PAYABLE

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities as of December 31, 2017 and 2016 is as follows:

	2017	2016
Patient accounts receivable		
Receivable from patients and their insurance carriers	\$ 28,507,144	\$ 35,842,731
Receivable from Medicare	24,908,956	21,264,158
Receivable from Medicaid	8,925,122	6,194,330
Receivable from long-term care operations	33,453,280	27,493,259
Total patient accounts receivable	95,794,502	90,794,478
Less contractual allowances	(36,102,359)	(31,882,602)
Less allowance for uncollectible amounts	(11,163,016)	(16,293,573)
Patient accounts receivable, net	<u>\$ 48,529,127</u>	<u>\$ 42,618,303</u>
Accounts payable and accrued expenses		
Payable to employees (including payroll taxes and benefits)	\$ 5,643,122	\$ 4,948,401
Payable to suppliers and other accrued expenses	69,298,282	60,035,239
Total accounts payable and accrued expenses	<u>\$ 74,941,404</u>	<u>\$ 64,983,640</u>

6. INVESTMENTS IN AFFILIATES

HRH owns 50% of Hancock Physician Network, LLC (Network) and has recorded the investment on the equity method of accounting in the amount of \$708,107 and \$1,019,093 as of December 31, 2017 and 2016, respectively. This investment is included within other assets in the combined financial statements. HRH paid the Network approximately \$4,459,000 and \$3,362,000 during 2017 and 2016, respectively for management and other operating expenses.

HRH received approximately \$5,109,000 and \$3,804,000 for 2017 and 2016, respectively from the Network for rental, housecleaning and related income. HRH contributed capital of approximately \$6,239,000 and \$5,479,000 to the Network during 2017 and 2016, respectively.

HRH has a receivable from the Network of approximately \$3,541,000 and \$1,872,000 as of December 31, 2017 and 2016, respectively. The Hospital has a payable to the Network of approximately \$1,069,000 and \$788,000 as of December 31, 2017 and 2016, respectively. HRH expects to continue providing capital contributions to the Network at a commensurate level with its past experience.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

HRH also owns 50% of a Physician Hospital Organization (PHO), approximately 43% of Suburban Home Health, LLC, and approximately 37% of Parkway, LLC. HRH has recorded these investments in affiliates on the equity method of accounting within other assets in the combined financial statements. HRH also owns 2% of St. Vincent Heart Center of Indiana, Inc.

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

7. CAPITAL ASSETS

Capital assets consist of the following as of December 31, 2017 and 2016:

	Balance December 31, 2016	Additions	Retirements	Transfers	Balance December 31, 2017
Land	\$ 1,241,194	\$ -0-	\$ (523,111)	\$ -0-	\$ 718,083
Land improvements	8,457,308	-0-	(654,665)	-0-	7,802,643
Buildings and fixed equipment	123,267,332	2,455,854	(4,494,086)	408,834	121,637,934
Major movable equipment	82,952,827	4,495,148	(3,603,011)	62,574	83,907,538
Construction in progress	276,302	1,361,864	-0-	(471,408)	1,166,758
Total capital assets	216,194,963	8,312,866	(9,274,873)	-0-	215,232,956
Less accumulated depreciation					
Land improvements	(5,056,771)	(447,825)	445,329	-0-	(5,059,267)
Buildings and fixed equipment	(73,070,075)	(4,591,981)	1,151,772	-0-	(76,510,284)
Major movable equipment	(58,357,382)	(5,264,658)	1,348,800	-0-	(62,273,240)
Total accumulated depreciation	(136,484,228)	(10,304,464)	2,945,901	-0-	(143,842,791)
Capital assets, net	\$ 79,710,735	\$ (1,991,598)	\$ (6,328,972)	\$ -0-	\$ 71,390,165

	Balance December 31, 2015	Additions	Retirements	Transfers	Balance December 31, 2016
Land	\$ 1,241,194	\$ -0-	\$ -0-	\$ -0-	\$ 1,241,194
Land improvements	6,845,390	36,900	-0-	1,575,018	8,457,308
Buildings and fixed equipment	113,252,238	3,053,383	-0-	6,961,711	123,267,332
Major movable equipment	76,965,791	4,535,703	(13,880)	1,465,213	82,952,827
Construction in progress	6,023,237	4,255,007	-0-	(10,001,942)	276,302
Total capital assets	204,327,850	11,880,993	(13,880)	-0-	216,194,963
Less accumulated depreciation					
Land improvements	(4,653,992)	(402,779)	-0-	-0-	(5,056,771)
Buildings and fixed equipment	(68,986,825)	(4,083,250)	-0-	-0-	(73,070,075)
Major movable equipment	(52,662,313)	(5,694,664)	(405)	-0-	(58,357,382)
Total accumulated depreciation	(126,303,130)	(10,180,693)	(405)	-0-	(136,484,228)
Capital assets, net	\$ 78,024,720	\$ 1,700,300	\$ (14,285)	\$ -0-	\$ 79,710,735

At December 31, 2017, the Hospital did not have any significant commitments related to capital assets.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

8. PATIENT SERVICE REVENUE

Patient service revenue for 2017 and 2016 consists of the following:

	2017	2016
Inpatient	\$ 67,143,714	\$ 75,573,423
Outpatient	288,401,369	249,149,722
Long-term care	348,589,632	353,474,422
Patient service revenue	704,134,715	678,197,567
Contractual allowance	210,716,066	192,634,328
Bad debts	10,976,962	11,862,680
Charity care	6,218,087	4,383,686
Deductions from revenue	227,911,115	208,880,694
Net patient service revenue	\$ 476,223,600	\$ 469,316,873

9. PENSION PLAN

The Hospital offers a defined contribution plan that covers all employees who meet eligibility requirements as to age and length of service and who elect to participate. The name of Plan is the Hancock Regional Hospital 403(b) Plan and is administered by MetLife. The plan was established by written agreement between the Board of Trustees and the plan administrator. The contribution requirements of participants of the plan are established and can be amended by written agreement. The Hospital matches 50% of the employee contribution up to 4% of the eligible wages. Pension expense related to this plan was approximately \$1,220,000 and \$1,355,000 in 2017 and 2016, respectively.

10. CONCENTRATION OF CREDIT RISK

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

	Receivables		Revenue	
	2017	2016	2017	2016
Medicare	40%	35%	52%	53%
Medicaid	14%	10%	11%	10%
Commercial	28%	29%	33%	33%
Self pay and other	18%	26%	4%	4%
	100%	100%	100%	100%

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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

11. ACCOUNTING FOR NONCONTROLLING INTEREST

The following depicts the changes in combined net position attributable to the controlling financial interest of the Hospital and the noncontrolling interest as of December 31, 2017 and 2016:

	Controlling interest	Noncontrolling interest	Total
Net position			
December 31, 2015	\$ 167,494,950	\$ 2,231,678	\$ 169,726,628
Change in net position before capital distributions	30,354,633	1,284,192	31,638,825
Capital distributions	-0-	(1,171,726)	(1,171,726)
Change in net position	30,354,633	112,466	30,467,099
December 31, 2016	197,849,583	2,344,144	200,193,727
Change in net position before capital distributions	38,778,723	1,405,477	40,184,200
Capital distributions	-0-	(1,595,670)	(1,595,670)
Change in net position	38,778,723	(190,193)	38,588,530
December 31, 2017	\$ 236,628,306	\$ 2,153,951	\$ 238,782,257

12. SELF-INSURED HEALTH CLAIMS

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

The Hospital maintains reinsurance including a stop loss for specific incident claims generally over \$300,000. Substantially all employees are covered for major medical benefits. The total health claims expense was approximately \$7,532,000 and \$7,827,000 for 2017 and 2016, respectively.

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Changes in the accrual for unpaid claims for 2017 and 2016 are as follows:

	2017	2016
Unpaid claims estimate, beginning of year	\$ 584,679	\$ 497,652
Incurring claims and changes in estimates	7,531,807	7,826,812
Claims payments	(7,133,170)	(7,739,785)
Unpaid claims estimate, end of year	<u>\$ 983,316</u>	<u>\$ 584,679</u>

13. COMMITMENTS AND CONTINGENCIES

Malpractice Insurance

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

The Hospital may be liable for certain pending claims incurred while with the former carrier. Management is not aware of any related material adverse effects to its financial position, results of operations, and cash flows. Prior to July 1, 1999, the Indiana Medical Malpractice Act provided for a maximum recovery of \$750,000 per individual (\$3,000,000 annual aggregate) for professional liability, \$100,000 of which would be paid through the Hospital's malpractice insurance coverage and the balance would be paid by the State of Indiana Patient Compensation Fund (Fund). For claims on or after July 1, 1999 and before July 1, 2017, the Indiana Medical Malpractice Act provides for a maximum recovery of \$1,250,000 per individual (\$7,500,000 annual aggregate) with the first \$250,000 covered by the Hospital's insurance and the remainder by the Fund. For claims on or after July 1, 2017 the Act provides a maximum recovery of \$1,650,000 for an occurrence of malpractice until June 30, 2019, and \$1,800,000 thereafter. The Act requires the Hospital to maintain medical malpractice liability insurance in the amount of at least \$400,000 per occurrence (\$8,000,000 or \$12,000,000 in the annual aggregate based on hospital bed size) until June 30, 2019. Starting July 1, 2019, the Act will require the Hospital to maintain medical malpractice liability insurance in the amount of at least \$500,000 per occurrence (\$10,000,000 or \$15,000,000 in the annual aggregate based on hospital bed size). The Act also requires the Hospital to pay a surcharge to the State Patient's Compensation Fund (Fund). The Fund is used to pay medical malpractice claims in excess of per occurrence and the annual aggregate amounts as noted above, under certain terms and conditions. No accrual for possible losses attributable to incidents that may have occurred but that have not been identified has been made because the amount, if any, is not reasonably estimable. The Fund is on a claims-made basis and as long as this coverage is continuous or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be insured.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claim experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

14. BLENDED COMPONENT UNITS

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

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

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

	2016			
	Foundation	HRSC	O3PureMed	Total
Assets				
Current assets	\$ 1,783,688	\$ 5,065,337	\$ 113,374	\$ 6,962,399
Capital assets	9,495	873,524	1,309,088	2,192,107
Assets whose use is limited	5,195,803	-0-	-0-	5,195,803
Total assets	<u>\$ 6,988,986</u>	<u>\$ 5,938,861</u>	<u>\$ 1,422,462</u>	<u>\$ 14,350,309</u>
Liabilities				
Accounts payable and other liabilities	122,453	1,020,013	99,287	1,241,753
Total liabilities	122,453	1,020,013	99,287	1,241,753
Net position				
Unrestricted	1,661,235	4,045,324	14,087	5,720,646
Net investment in capital assets	9,495	873,524	1,309,088	2,192,107
Donor restricted-expendable	5,195,803	-0-	-0-	5,195,803
Total net position	<u>6,866,533</u>	<u>4,918,848</u>	<u>1,323,175</u>	<u>13,108,556</u>
Total liabilities and net position	<u>\$ 6,988,986</u>	<u>\$ 5,938,861</u>	<u>\$ 1,422,462</u>	<u>\$ 14,350,309</u>
Operating revenues (patient and other)	\$ -0-	\$ 12,421,100	\$ 112,432	\$ 12,533,532
Expenses				
Depreciation	-0-	356,538	268,599	625,137
Other expenses	-0-	9,411,524	509,714	9,921,238
Total expenses	<u>-0-</u>	<u>9,768,062</u>	<u>778,313</u>	<u>10,546,375</u>
Operating income (loss)	-0-	2,653,038	(665,881)	1,987,157
Nonoperating revenues, net	663,759	-0-	-0-	663,759
Capital contributions (distributions)	<u>-0-</u>	<u>(2,600,000)</u>	<u>400,000</u>	<u>(2,200,000)</u>
Change in net position	663,759	53,038	(265,881)	450,916
Net position, beginning of year	6,202,774	4,865,810	1,589,056	12,657,640
Net position, end of year	<u>\$ 6,866,533</u>	<u>\$ 4,918,848</u>	<u>\$ 1,323,175</u>	<u>\$ 13,108,556</u>
Net cash flows from				
Operating activities	\$ -0-	\$ 3,009,576	\$ (509,714)	\$ 2,499,862
Noncapital financing activities	202,538	-0-	-0-	202,538
Capital and related financing activities	-0-	(2,937,667)	603,269	(2,334,398)
Investing activities	<u>(310,490)</u>	<u>-0-</u>	<u>-0-</u>	<u>(310,490)</u>
Total	(107,952)	71,909	93,555	57,512
Cash and cash equivalents:				
Beginning of year	485,937	2,862,049	10,012	3,357,998
End of year	<u>\$ 377,985</u>	<u>\$ 2,933,958</u>	<u>\$ 103,567</u>	<u>\$ 3,415,510</u>

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