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December 27, 2019

Board of Governors
Daviness Community Hospital
1314 E. Walnut Street
Washington, IN 47501

We have reviewed the audit report of Daviness Community Hospital, which was opined upon by BKD, LLP, Independent Public Accountants, for the period January 1, 2018 to December 31, 2018. Per the *Independent Auditor's Report*, the financial statements included in the report present fairly the financial condition of Daviness Community Hospital, as of December 31, 2018, and the results of its operations for the period then ended, on the basis of accounting described in the report.

We call your attention to the finding in the report on page 38. The Hospital's planned corrective action is included in the Views of Responsible Officials section of the finding.

In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts.

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

Daviess Community Hospital
A Component Unit of Daviess County, Indiana

Independent Auditor's Report and Financial Statements

December 31, 2018 and 2017

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
December 31, 2018 and 2017

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Independent Auditor's Report

Board of Governors
Daviess Community Hospital
Washington, Indiana

Report on the Financial Statements

We have audited the accompanying financial statements of Daviess Community Hospital (Hospital), a component unit of Daviess County, Indiana, as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents 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 audit 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.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Hospital's basic financial statements. The combining schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining schedules are the responsibility of management and were derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements, and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining schedules are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated November 25, 2019, on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Hospital's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

BKD, LLP

Indianapolis, Indiana
November 25, 2019

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Management's Discussion and Analysis
December 31, 2018 and 2017

Introduction

This management's discussion and analysis of the financial performance of Daviess Community Hospital, a component unit of Daviess County, Indiana (Hospital), provides an overview of the Hospital's financial activities for the years ended December 31, 2018 and 2017. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and investments increased in 2018 by \$8,671,227 or 28.0% and increased in 2017 by \$17,393,113 or 127.8%.
- The Hospital's net position increased in 2018 by \$9,455,898 or 31.5% and increased in 2017 by \$6,863,303 or 29.6%.
- The Hospital reported operating income in 2018 and 2017 of \$10,676,558 and \$8,644,922, respectively. The operating results in 2018 improved by \$2,031,636 or 23.5% over the operating income reported in 2017. The operating results in 2017 improved by \$8,254,585 or 2,114.7% over the operating income reported in 2016.
- Net nonoperating expenses improved by \$560,959 or 31.5% in 2018 compared to the decline of \$963,136 or 117.7% in 2017.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net position; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

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

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

These two statements report the Hospital's net position and changes in net position. The Hospital's total net position—the difference between assets, deferred outflows of resources and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net position is an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

Statements of Cash Flows

The statements of cash flows reports cash receipts, cash payments and net changes in cash resulting from our defined types of 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 and cash equivalents during the reporting period.

Hospital's Net Position

The Hospital's net position is the difference between its assets, deferred outflows of resources and liabilities reported in the balance sheets. The Hospital's net position increased by \$9,455,898 or 31.5% in 2018 over 2017 compared to the \$6,863,303 or 29.6% increase in 2017 over 2016, as shown in Table 1.

	2018	2017	2016
Assets and Deferred Outflows of Resources			
Patient accounts receivable, net	\$ 26,743,276	\$ 24,930,220	\$ 17,797,363
Other current assets	54,612,978	41,521,454	21,928,960
Capital assets, net	32,398,393	32,626,401	28,364,596
Other noncurrent assets and deferred outflows of resources	7,544,584	7,906,623	6,558,362
Total assets and deferred outflows of resources	<u>\$ 121,299,231</u>	<u>\$ 106,984,698</u>	<u>\$ 74,649,281</u>
Liabilities			
Long-term debt (including current portion)	\$ 19,285,287	\$ 20,984,014	\$ 17,936,647
Other current and noncurrent liabilities	62,538,961	55,981,599	33,556,852
Total liabilities	<u>81,824,248</u>	<u>76,965,613</u>	<u>51,493,499</u>
Net Position			
Net investment in capital assets	13,113,106	11,642,387	10,427,949
Restricted for debt service	3,263,070	3,236,331	3,197,128
Unrestricted	23,098,807	15,140,367	9,530,705
Total net position	<u>39,474,983</u>	<u>30,019,085</u>	<u>23,155,782</u>
Total liabilities and net position	<u>\$ 121,299,231</u>	<u>\$ 106,984,698</u>	<u>\$ 74,649,281</u>

A significant change in assets during 2018 is the increase in other current assets, which increased by \$13,091,524 (31.5%) in 2018 compared to 2017. This increase was primarily a result of an increase in cash of \$8,641,682 (31.6%) attributable from improvements in Hospital operations and the addition of new long-term care facilities. The most significant change in assets during 2017 was other current assets. Other current assets increased by approximately \$19,592,494 (89.4%) in 2017 primarily as a result of the lease agreements related to the operations of eighteen additional long-term care facilities.

Operating Results and Changes in the Hospital's Net Position

In 2018, the Hospital's net position increased by \$9,455,898 or 31.5% as shown in Table 2. This increase is made up of several components and represents an improvement of 37.8% compared with the increase in net position for 2017 of \$6,863,303 or 29.6%. Of note, during 2018 and 2017, the Hospital recognized revenue approximating \$39.1 million and \$32.0 million, respectively, related to its participation in the Indiana Medicaid Upper Payment Limit (UPL) program with its expanded nursing home operations. These amounts are recorded in other operating revenues.

	2018	2017	2016
Operating Revenues			
Net patient service revenue	\$ 249,385,280	\$ 214,054,817	\$ 143,445,639
Other operating revenues	42,376,726	34,485,499	15,434,547
Total operating revenues	<u>291,762,006</u>	<u>248,540,316</u>	<u>158,880,186</u>
Operating Expenses			
Salaries, wages, contract labor and employee benefits	136,430,541	116,297,141	78,565,667
Purchased services and professional fees	47,117,555	37,701,130	19,726,627
Depreciation and amortization	3,636,475	3,588,170	3,168,910
Provider hospital assessment fee	3,450,469	2,808,515	2,277,328
Other operating expenses	90,450,408	79,500,438	54,751,317
Total operating expenses	<u>281,085,448</u>	<u>239,895,394</u>	<u>158,489,849</u>
Operating Income	<u>10,676,558</u>	<u>8,644,922</u>	<u>390,337</u>
Nonoperating Revenues (Expenses)			
Investment income	127,433	78,442	71,696
Interest expense	(1,513,964)	(1,363,180)	(1,140,572)
Noncapital grants and contributions	126,878	85,068	65,815
Other nonoperating revenues and expenses, net	38,993	(581,949)	184,578
Total nonoperating expenses	<u>(1,220,660)</u>	<u>(1,781,619)</u>	<u>(818,483)</u>
Increase (Decrease) in Net Position	<u>\$ 9,455,898</u>	<u>\$ 6,863,303</u>	<u>\$ (428,146)</u>

Operating Results

The first component of the overall change in the Hospital's net position is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In each of the past three years, the Hospital has reported improved operating results, with an operating income each year.

Operating income for 2018 improved by \$2,031,636 or 23.5% as compared to operating income of \$8,644,922 recognized in 2017. The primary changes that led to the improvement in operating income are:

- An increase in net patient service revenue of approximately \$35.3 million or 16.5%.
- An increase in other operating revenue of approximately \$7.9 million or 22.9%.
- An increase in total operating expenses of approximately \$41.2 million or 17.2%.

Net patient service revenue increased during 2018 as a result of improvements in Hospital volumes and additional revenues from new long-term care facilities during the year. Increases in other operating revenues are attributed to UPL revenue approximating \$39.1 million recognized with the increase in nursing home operations.

Total operating expenses increased in 2018 as a result of the leases related to additional long-term care facilities during the year. Salaries, wages, contract labor and employee benefits increased approximately \$20.1 million or 17.3% while purchased services and professional fees increased approximately \$9.4 million or 25.0%.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income, interest expense, and losses on disposal of capital assets. Interest expense in both 2018 and 2017 was comparable to that recognized in the prior year, increasing by \$150,784 in 2018 and \$222,608 in 2017. The Hospital recognized losses on disposal of capital assets in each of 2018 and 2017 totaling \$374,927 and \$579,838, respectively, which is included in other nonoperating expense.

Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating results and net nonoperating revenues and expenses for 2018 and 2017, discussed earlier. Changes in operating results led to a decrease in cash provided by operating activities of \$2,808,673 and an increase of \$6,229,830 in 2018 and 2017, respectively. Cash provided by capital and related financing activities decreased by \$6,040,615 and increased by \$6,229,830 in 2018 and 2017, respectively, as a result of draws and repayments on the Hospital's line of credit, which was primarily used to fund the Intergovernmental expense required to draw down Upper Payment Limit revenue (see Note 2).

Capital Asset and Debt Administration

Capital Assets

At the end of 2018 and 2017, the Hospital had \$32,398,393 and \$32,626,401 invested in capital assets, net of accumulated depreciation, respectively, as detailed in Note 6 to the financial statements. The Hospital purchased new capital assets costing approximately \$3.8 million in 2018 and \$8.6 million in 2017. Included in these additions are assets acquired through capital lease obligations totaling approximately \$376,000 and \$4,917,000 in 2018 and 2017, respectively.

Debt

At December 31, 2018, the Hospital had \$14,740,000 in revenue bonds outstanding compared to \$15,740,000 at December 31, 2017. The Hospital issued no new debt outside of that issued under capital leases. The Hospital's formal revenue bonds are subject to limitations imposed by state law. See Note 9 to the financial statements for more information regarding long-term debt.

Line of Credit

The Hospital had a \$6,000,000 revolving bank line of credit, which expired in February 2017. This agreement was extended to January 2019 and the total principal available increased to \$30 million (see Note 10). There was \$22,855,972 and \$17,472,288 borrowed against this line at December 31, 2018 and 2017, respectively. The line is collateralized by certain deposit accounts held with the bank. Interest varies with the bank's prime rate less 1.5%, which was 4.0% on December 31, 2018, and is payable monthly.

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. Questions about this report and requests for additional financial information should be directed to the Hospital Business Administration by telephoning 812.254.2760.

Daviess Community Hospital

A Component Unit of Daviess County, Indiana

Balance Sheets December 31, 2018 and 2017

Assets and Deferred Outflows of Resources

	2018	2017
Current Assets		
Cash	\$ 35,957,744	\$ 27,316,062
Patient accounts receivable, net of allowance of \$10,219,126 and \$4,881,715 for 2018 and 2017, respectively	26,743,276	24,930,220
Supplies	1,380,441	1,424,962
Prepaid expenses and other	16,750,793	12,172,258
Estimated amounts due from third-party payers	524,000	608,172
Total current assets	<u>81,356,254</u>	<u>66,451,674</u>
Noncurrent Cash and Investments		
Internally designated	452,139	449,333
Held by trustee for debt service	3,263,070	3,236,331
	<u>3,715,209</u>	<u>3,685,664</u>
Capital Assets, net	<u>32,398,393</u>	<u>32,626,401</u>
Other Assets	<u>1,662,819</u>	<u>1,839,538</u>
Deferred Outflows of Resources - debt defeasance costs	<u>2,166,556</u>	<u>2,381,421</u>
Total assets and deferred outflows of resources	<u>\$ 121,299,231</u>	<u>\$ 106,984,698</u>

Liabilities and Net Position

Current Liabilities		
Current maturities of long-term debt	\$ 2,461,017	\$ 2,255,080
Line of credit	22,855,972	17,472,288
Accounts payable and accrued expenses	39,529,977	38,350,311
Estimated amounts due to third-party payers	153,012	159,000
Total current liabilities	<u>64,999,978</u>	<u>58,236,679</u>
Long-Term Debt	<u>16,824,270</u>	<u>18,728,934</u>
Total liabilities	<u>81,824,248</u>	<u>76,965,613</u>
Net Position		
Net investment in capital assets	13,113,106	11,642,387
Restricted for debt service	3,263,070	3,236,331
Unrestricted	23,098,807	15,140,367
Total net position	<u>39,474,983</u>	<u>30,019,085</u>
Total liabilities and net position	<u>\$ 121,299,231</u>	<u>\$ 106,984,698</u>

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts of \$9,824,179 and \$5,929,531 for 2018 and 2017, respectively	\$ 249,385,280	\$ 214,054,817
Other	<u>42,376,726</u>	<u>34,485,499</u>
Total operating revenues	<u>291,762,006</u>	<u>248,540,316</u>
Operating Expenses		
Salaries, wages and contract labor	116,765,435	97,500,241
Employee benefits	19,665,106	18,796,900
Purchased services and professional fees	47,117,555	37,701,130
Supplies	23,287,407	20,889,310
Insurance	3,668,512	2,503,870
Utilities	6,489,250	5,487,828
Rent	26,802,386	22,498,920
Repairs and maintenance	6,827,663	5,306,743
Provider hospital assessment fee	3,450,469	2,808,515
Depreciation and amortization	3,636,475	3,588,170
Other	<u>23,375,190</u>	<u>22,813,767</u>
Total operating expenses	<u>281,085,448</u>	<u>239,895,394</u>
Operating Income	<u>10,676,558</u>	<u>8,644,922</u>
Nonoperating Revenues (Expenses)		
Investment income	127,433	78,442
Interest expense	(1,513,964)	(1,363,180)
Noncapital grants and contributions	126,878	85,068
Other	<u>38,993</u>	<u>(581,949)</u>
Total nonoperating expenses	<u>(1,220,660)</u>	<u>(1,781,619)</u>
Increase in Net Position	9,455,898	6,863,303
Net Position, Beginning of Year	<u>30,019,085</u>	<u>23,155,782</u>
Net Position, End of Year	<u>\$ 39,474,983</u>	<u>\$ 30,019,085</u>

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating Activities		
Receipts from and on behalf of patients	\$ 285,838,514	\$ 234,282,051
Payments to suppliers and contractors	(116,173,625)	(82,613,149)
Payments to employees and contract labor	(136,646,812)	(116,264,506)
Other payments, net	(23,596,057)	(23,173,703)
Net cash provided by operating activities	<u>9,422,020</u>	<u>12,230,693</u>
Noncapital Financing Activity - Noncapital grants and contributions	<u>126,878</u>	<u>85,068</u>
Capital and Related Financing Activities		
Principal paid on capital leases	(1,070,390)	(909,638)
Principal paid on long-term debt	(1,000,000)	(955,000)
Borrowings on line of credit	22,876,213	18,072,288
Repayments on line of credit	(17,492,529)	(6,528,502)
Interest paid on long-term debt and capital leases	(1,328,771)	(1,168,504)
Purchase of capital assets	(3,403,547)	(3,679,523)
Other capital and related financing activities	379,430	169,900
Net cash provided by (used in) capital and related financing activities	<u>(1,039,594)</u>	<u>5,001,021</u>
Investing Activities		
Interest and dividends on investments	127,433	78,442
Purchase of investments	(29,376)	(43,615)
Other investing activities	34,490	(2,111)
Net cash provided by investing activities	<u>132,547</u>	<u>32,716</u>
Increase in Cash	8,641,851	17,349,498
Cash, Beginning of Year	<u>27,409,171</u>	<u>10,059,673</u>
Cash, End of Year	<u>\$ 36,051,022</u>	<u>\$ 27,409,171</u>
Reconciliation of Cash to the Balance Sheets		
Cash	\$ 35,957,744	\$ 27,316,062
Noncurrent cash and investments - internally designated	93,278	93,109
	<u>\$ 36,051,022</u>	<u>\$ 27,409,171</u>

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Statements of Cash Flows (Continued)
Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Reconciliation of Operating Income to		
Net Cash Provided by Operating Activities		
Operating income	\$ 10,676,558	\$ 8,644,922
Depreciation and amortization	3,636,475	3,588,170
Provision for uncollectible accounts	9,824,179	5,929,531
Changes in operating assets and liabilities:		
Patient accounts receivable	(11,637,235)	(13,062,388)
Estimated amounts due to/from third-party payers	78,184	(535,465)
Accounts payable and accrued expenses	1,204,666	11,366,496
Other assets and liabilities	<u>(4,360,807)</u>	<u>(3,700,573)</u>
Net cash provided by operating activities	<u>\$ 9,422,020</u>	<u>\$ 12,230,693</u>
Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets	\$ 376,335	\$ 4,916,677

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Notes to Financial Statements
December 31, 2018 and 2017

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

Daviess Community Hospital (Hospital) is an acute care hospital located in Washington, Indiana. The Hospital is a component unit of Daviess County (County) and the Board of County Commissioners appoints members to the Board of Governors of the Hospital, pursuant to the provisions of Indiana Code 16-22-2-2. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Daviess County area.

The Hospital operates thirty-seven long-term care nursing facilities (LTC) through various lease arrangements as of December 31, 2018. These facilities provide inpatient and therapy services in its geographic area and supports the Hospital's mission to provide quality care and services to the facility's residents. The facilities are managed by third parties under various management agreements. The revenues from operations are the property of the Hospital and the Hospital is responsible for the associated operating expenses and working capital requirements.

In accordance with GASB Statement No. 61, the financial statements include the financial statements of the Daviess Community Hospital Foundation (Foundation). The Foundation's purpose is to provide philanthropic support through fundraising and other activities for the acquisition of equipment, facility development and support of programs at the Hospital, and has therefore been reported as a blended component unit.

During 2014, the Hospital invested in a 51% ownership in Daviess Community Hospital Pain Management, LLC (Pain Management), which is organized to offer pain management services in the Hospital's primary service area. The Hospital's ownership interest is accounted for under the equity method. Separate audited financial statements are not issued for Pain Management.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets, liabilities and deferred outflows of resources from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally state grants and county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

Daviess Community Hospital

A Component Unit of Daviess County, Indiana

Notes to Financial Statements

December 31, 2018 and 2017

Use of Estimates

The preparation of 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, liabilities and deferred outflows of resources and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Risk Management

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

The Hospital is self-insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and Investment Income

Investments in nonnegotiable certificates of deposit are carried at amortized cost. The investment in equity investee is reported on the equity method of accounting. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income includes dividend and interest income.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Daviess Community Hospital

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Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	5 - 25 years
Buildings and leasehold improvements	5 - 40 years
Equipment	3 - 20 years

Capital Asset Impairment

The Hospital evaluates capital assets for impairment whenever events or circumstances indicate a significant, unexpected decline in the service utility of a capital asset has occurred. If a capital asset is tested for impairment and the magnitude of the decline in service utility is significant and unexpected, accumulated depreciation is increased by the amount of the impairment loss. No asset impairment was recognized during the years ended December 31, 2018 and 2017.

Deferred Outflows of Resources

The Hospital reports the consumption of net position that is applicable to a future period as deferred outflows of resources in a separate section of its balance sheets.

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date. The estimated compensated absences liability is expected to be paid within one year of the balance sheet date, and is therefore included in current liabilities.

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Net Position

Net position of the Hospital is classified in three components. Net investment in capital assets, consist of capital assets, net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. The restricted component of net position is noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets or restricted net position.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were \$661,765 and \$673,589 for 2018 and 2017, respectively. The costs of charity care provided under the Hospital's charity care policy were \$226,308 and \$240,178 for 2018 and 2017, respectively. The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross uncompensated charges.

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. In addition, the Hospital is exempt from taxes under Section 501(c)(3) of the Internal Revenue Code. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

The Foundation is exempt from federal income taxes under Section 501(c)(3) of the U.S. Internal Revenue Code and a similar provision of state law. However, the Foundation is subject to federal income tax on any unrelated business taxable income.

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Foundation

Daviess Community Hospital Foundation, Inc. (Foundation) is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs. The board of the Foundation is self-perpetuating. Separate financial statements of the Foundation may be obtained by contacting its office at 1314 East Walnut Street, Washington, IN 47501.

Reclassifications

Certain reclassifications have been made to the 2017 financial statements to conform to the 2018 financial statement presentation. These reclassifications had no impact on the change in net position.

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Certain inpatient nonacute services are paid based on a cost reimbursement methodology. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Long-term care services rendered to Medicare program beneficiaries are paid under a prospectively determined payment system on a per diem basis based on each resident's health at admission. Medicare reimburses for 100 days of skilled nursing facility care is subject to certain eligibility requirements.

Medicaid. Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates. These rates vary according to the service provided and the patient diagnosis.

Long-term care services rendered to Medicaid program beneficiaries are paid on a per diem basis.

Approximately 70% and 67% of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2018 and 2017, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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The Hospital qualifies as a Medicaid Disproportionate Share Hospital (DSH) provider under Indiana law and, as such, is eligible to receive supplemental Medicaid payments. The amounts of these supplemental payments are dependent on regulatory approval by agencies of the federal and state governments and is determined by level, extent and cost of uncompensated care and various other factors. Supplemental payments have been made by the State of Indiana, and the Hospital records such amounts as revenue when it has been reasonably determined that the funds will be received. The Hospital recognized approximately \$624,000 within patient service revenue related to this supplemental payment program for each of the years ended December 31, 2018 and 2017. Net deferred revenue at December 31, 2018 related to advance funding of payments approximate \$62,000 and are included in prepaid expenses and other assets. Amounts outstanding at December 31, 2017 approximating \$312,000 is accrued as a receivable in prepaid expenses and other assets. This represents management's best estimate of DSH funds due to the Hospital, which are typically paid in arrears.

The Hospital participates in a state-specific provider assessment program to increase Medicaid payments to hospitals. The Hospital paid approximately \$3.5 million and \$2.8 million for 2018 and 2017, respectively, into this Medicaid program, which is recorded as an operating expense in the statements of revenues, expenses and changes in net position. In January 2017, the Hospital received notice that its Medicaid Inpatient Utilization Rate (MIUR) continued to exceed state-wide thresholds, as defined by state regulation. A benefit of having a MIUR exceeding the threshold includes a 25% reduction in the provider assessment fee. The state measures the MIUR no less than every four years and no more than every two years. At each measurement period, the state-defined MIUR changes, which may affect the Hospital. Any changes in the amount of tax dues as a result of eligibility changes will be recorded in the period once the state has made its determination. The provider assessment fee program is subject to further retroactive rate setting by the state of Indiana and its Medicaid program and the amounts expensed represent the current fees that have been assessed to the Hospital, including the 25% benefit.

The long-term care operations of the Hospital qualify for supplemental Medicaid payments through the Upper Payment Limit (UPL) program. The UPL is established to pay qualifying providers the difference between what Medicare would have paid and what Medicaid actually paid. The UPL is distributed through an intergovernmental transfer (IGT) arrangement. The Hospital is responsible for funding the IGT long-term care operations. Revenue associated with the UPL program is recorded net of IGT payments made to the program and are included in other operating revenue. The Hospital recognized approximately \$39,147,000 and \$32,037,000 related to this supplemental payment program for the years ended December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, respectively, approximately \$10,736,000 and \$9,777,000 is accrued and included in prepaid expenses and other assets.

The Hospital has also 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.

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Note 3: Deposits, Investments and Investment Income

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of state law.

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depositary Insurance Corporation (FDIC) or by the Indiana Public Deposit Insurance Fund (IPDIF). This includes any deposit accounts issued or offered by a qualifying financial institution. Accordingly, all deposits in excess of FDIC levels are covered by the IPDIF and are considered collateralized.

Investments

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest to a limited extent in certain deposit accounts, mutual funds, repurchase agreements and pooled investment funds as authorized by Indiana Code 16-22-3-20.

At December 31, 2018 and 2017, the Hospital had the following investments and maturities:

December 31, 2018					
Type	Fair Value	Maturities in Years			
		Less Than 1	1-5	6-10	More Than 10
Money market mutual funds	\$ 3,367,670	\$ 3,367,670	\$ -	\$ -	\$ -

December 31, 2017					
Type	Fair Value	Maturities in Years			
		Less Than 1	1-5	6-10	More Than 10
Money market mutual funds	\$ 3,340,811	\$ 3,340,811	\$ -	\$ -	\$ -

Interest Rate Risk - Interest rate risk is the risk that the changes in interest rates will adversely affect the fair value of an investment. The Hospital does not have a formal investment policy for interest rate risk.

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. The Hospital does not have a formal investment policy for credit risk. At December 31, 2018 and 2017, the Hospital's investments were not rated.

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Custodial Credit Risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The Hospital's investment policy does not address how securities underlying repurchase agreements are to be held.

Concentration of Credit Risk - The Hospital places no limit on the amount that may be invested in any one issuer.

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets as follows:

	2018	2017
Carrying value:		
Deposits	\$ 36,305,283	\$ 27,660,915
Investments	3,367,670	3,340,811
	<u>\$ 39,672,953</u>	<u>\$ 31,001,726</u>
Included in the following balance sheets captions:		
Cash	\$ 35,957,744	\$ 27,316,062
Noncurrent cash and investments	3,715,209	3,685,664
	<u>\$ 39,672,953</u>	<u>\$ 31,001,726</u>

Nonnegotiable certificates of deposit totaling \$254,261 and \$251,744 are included in deposit balances at December 31, 2018 and 2017, respectively.

Investment Income

Investment income for the years ended December 31 consisted of:

	2018	2017
Interest and dividend income	<u>\$ 127,433</u>	<u>\$ 78,442</u>

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Notes to Financial Statements December 31, 2018 and 2017

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31 consisted of:

	2018	2017
Medicare	\$ 10,867,938	\$ 8,622,685
Medicaid	13,690,878	10,659,378
Other third-party payers	4,954,045	4,694,322
Patients	7,449,541	5,835,550
	<u>36,962,402</u>	<u>29,811,935</u>
Less allowance for uncollectible accounts	<u>(10,219,126)</u>	<u>(4,881,715)</u>
	<u><u>\$ 26,743,276</u></u>	<u><u>\$ 24,930,220</u></u>

Note 5: Investment in Equity Investee

The investment in equity investee relate to a 51% ownership of Daviess Community Hospital Pain Management, LLC (Pain Management). The Hospital's investment at December 31, 2018 and 2017 was \$(45,485) and \$36,938, respectively, and is recorded in other noncurrent assets. The Hospital provides support to the joint venture through labor and supply costs which are billed to Pain Management on a monthly basis. The Hospital also provides billing and collections services for Pain Management and remits patient collections to the joint venture to satisfy operating expenses. Financial positions and results of operations of the investee are summarized below:

	2018	2017
Current and total assets	\$ 43,240	\$ 135,572
Current and total liabilities	<u>35,244</u>	<u>63,144</u>
Members' equity	<u><u>\$ 7,996</u></u>	<u><u>\$ 72,428</u></u>
Revenues	\$ 259,564	\$ 347,606
Excess (deficiency) of revenues over expenses	\$ (64,431)	\$ 25,024

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Note 6: Capital Assets

The Hospital's property and equipment consist of the following:

2018					
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 1,280,955	\$ -	\$ -	\$ -	\$ 1,280,955
Land improvements	687,865	-	-	-	687,865
Buildings and leasehold improvements	47,254,884	1,906,241	(360,518)	-	48,800,607
Equipment	35,741,926	636,518	(140,660)	526,879	36,764,663
Construction in progress	177,027	1,237,123	-	(526,879)	887,271
	<u>85,142,657</u>	<u>3,779,882</u>	<u>(501,178)</u>	<u>-</u>	<u>88,421,361</u>
Less accumulated depreciation:					
Land improvements	681,038	2,471	-	-	683,509
Buildings and leasehold improvements	21,437,948	2,000,344	-	-	23,438,292
Equipment	30,397,270	1,630,148	(126,251)	-	31,901,167
	<u>52,516,256</u>	<u>3,632,963</u>	<u>(126,251)</u>	<u>-</u>	<u>56,022,968</u>
Capital assets, net	<u>\$ 32,626,401</u>	<u>\$ 146,919</u>	<u>\$ (374,927)</u>	<u>\$ -</u>	<u>\$ 32,398,393</u>

2017					
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 1,280,955	\$ -	\$ -	\$ -	\$ 1,280,955
Land improvements	687,865	-	-	-	687,865
Buildings and leasehold improvements	41,259,981	5,565,613	(270,078)	699,368	47,254,884
Equipment	33,517,486	2,008,791	(140,847)	356,496	35,741,926
Construction in progress	879,157	1,021,796	(668,062)	(1,055,864)	177,027
	<u>77,625,444</u>	<u>8,596,200</u>	<u>(1,078,987)</u>	<u>-</u>	<u>85,142,657</u>
Less accumulated depreciation:					
Land improvements	676,571	4,467	-	-	681,038
Buildings and leasehold improvements	19,943,312	1,684,584	(189,948)	-	21,437,948
Equipment	28,640,965	1,895,606	(139,301)	-	30,397,270
	<u>49,260,848</u>	<u>3,584,657</u>	<u>(329,249)</u>	<u>-</u>	<u>52,516,256</u>
Capital assets, net	<u>\$ 28,364,596</u>	<u>\$ 5,011,543</u>	<u>\$ (749,738)</u>	<u>\$ -</u>	<u>\$ 32,626,401</u>

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Note 7: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance up to coverage limits under the Indiana Malpractice Act (the Act) under a claims-made policy on a fixed premium basis. The Hospital is covered under the Act which limits professional liability for claims prior to July 1, 2017 to a maximum recovery of \$1,250,000 per occurrence, \$250,000 of which would be paid through malpractice insurance coverage, while the remaining balance would be paid by the State of Indiana Patient Compensation Fund (the Fund). For claims on or after July 1, 2017, the maximum recovery is \$1,650,000 per occurrence, \$400,000 of which would be paid through malpractice insurance coverage, with the remainder due from the Fund. 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 claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 8: Employee Health Claims

Substantially all of the Hospital's employees and their dependents (excluding contract employees through long-term care nursing facility arrangements) are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of \$90,000 per enrollee. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability, which is included in accrued expenses in the balance sheets, during 2018 and 2017, is summarized as follows:

	2018	2017
Balance, beginning of year	\$ 325,060	\$ 475,000
Current year claims incurred and changes in estimate	3,392,972	3,177,174
Claims and expenses paid	<u>(3,442,641)</u>	<u>(3,327,114)</u>
Balance, end of year	<u><u>\$ 275,391</u></u>	<u><u>\$ 325,060</u></u>

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Note 9: Long-Term Obligations

The following is a summary of long-term obligation transactions for the Hospital for the years ended December 31:

	2018				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt:					
Series 2011 refunding revenue bonds	\$ 15,740,000	\$ -	\$ (1,000,000)	\$ 14,740,000	\$ 1,040,000
Unamortized bond premium	51,779	-	(4,672)	47,107	-
Capital lease obligations	5,192,235	376,335	(1,070,390)	4,498,180	1,421,017
Total long-term debt	<u>\$ 20,984,014</u>	<u>\$ 376,335</u>	<u>\$ (2,075,062)</u>	<u>\$ 19,285,287</u>	<u>\$ 2,461,017</u>

	2017				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt:					
Series 2011 refunding revenue bonds	\$ 16,695,000	\$ -	\$ (955,000)	\$ 15,740,000	\$ 1,000,000
Unamortized bond premium	56,451	-	(4,672)	51,779	-
Capital lease obligations	1,185,196	4,916,677	(909,638)	5,192,235	1,255,080
Total long-term debt	<u>\$ 17,936,647</u>	<u>\$ 4,916,677</u>	<u>\$ (1,869,310)</u>	<u>\$ 20,984,014</u>	<u>\$ 2,255,080</u>

Series 2011 Revenue Refunding Bonds Payable

The Series 2011 revenue refunding bonds payable consist of lease rental revenue bonds (bonds) in the original amount of \$20,135,000 dated May 2011, which bear interest at 3% to 5.25%. Beginning in 2013, the bonds are payable in annual installments through January 15, 2029. The Hospital is required to make monthly deposits to the debt service fund held by the trustee, and interest payments are payable January 15th and July 15th annually. The bonds are secured by the net revenues and accounts receivable of the Hospital and the assets restricted under the bond indenture agreement.

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The debt service requirements as of December 31, 2018 are as follows:

Year Ending December 31,	Total to be Paid	Principal	Interest
2019	\$ 1,768,788	\$ 1,040,000	\$ 728,788
2020	1,770,988	1,090,000	680,988
2021	1,765,813	1,135,000	630,813
2022	1,761,200	1,190,000	571,200
2023	1,762,019	1,255,000	507,019
2024-2028	8,773,082	7,325,000	1,448,082
2029	1,749,756	1,705,000	44,756
	<u>\$ 19,351,646</u>	<u>\$ 14,740,000</u>	<u>\$ 4,611,646</u>

Capital Lease Obligations

The Hospital is obligated under leases for equipment and facilities that are accounted for as capital leases. The following is a schedule by year of future minimum lease payments under the capital lease including interest at rates ranging from 3.42% to 5.00% together with the present value of the future minimum lease payments as of December 31, 2018:

2019	\$ 1,581,887
2020	922,040
2021	734,064
2022	635,805
2023	545,400
2024-2028	605,833
Total minimum lease payments	<u>5,025,029</u>
Less amount representing interest	<u>526,849</u>
Present value of future minimum lease payments	<u>\$ 4,498,180</u>

Assets under capital leases at December 31, totaled:

	<u>2018</u>	<u>2017</u>
Machinery and equipment	\$ 6,918,986	\$ 6,542,651
Accumulated depreciation	<u>(2,417,387)</u>	<u>(1,396,454)</u>
	<u>\$ 4,501,599</u>	<u>\$ 5,146,197</u>

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Note 10: Line of Credit

In 2016, the Hospital entered into a \$6,000,000 revolving bank line of credit. The original agreement has been subsequently amended to increase the principal to \$30,000,000 and extend the maturity, which expired in January 2019. At December 31, 2018 and 2017, respectively, there was \$22,855,972 and \$17,472,288 borrowed against this line. The line is collateralized by certain deposit accounts held with the bank. Interest varies with the bank's prime rate less 1.5%, which was 4.0% on December 31, 2018, and is payable monthly. Subsequent to December 31, 2018, the agreement was amended to extend the maturity date to January 2020.

Note 11: Pension Plan

The Hospital contributes to a defined-contribution 403(b) pension plan covering substantially all employees after one year of service (excluding contract employees through long-term care nursing facility arrangements). Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by a board of governors. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's board of governors. The Hospital will match 50% of the employee's contributions into the plan up to a maximum of 6% contribution by the employee. Employees are 100% vested in their own contributions and are vested on an increasing scale from 0% to 100% over 5 years in Hospital contributions. Hospital contributions aggregated \$366,593 and \$326,718 during 2018 and 2017, respectively.

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Note 12: Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

The Hospital has money market mutual funds of \$3,367,670 and \$3,340,811 at December 31, 2018 and 2017, respectively, which are valued on a recurring measurement at fair value using the net asset value per share (or its equivalent) as a practical expedient and are not classified in the fair value hierarchy. These money market mutual funds invest in short-term debt securities and seek to provide greater returns than cash deposits. There are no unfunded commitments or restrictions on redemptions.

Note 13: Contingencies

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

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Note 14: Condensed Combining Information

The following tables include condensed combining balance sheet information for the Hospital and its blended component unit as of December 31, 2018 and 2017:

	December 31, 2018		
	Hospital	Foundation	Total
Assets			
Current assets	\$ 81,262,724	\$ 93,530	\$ 81,356,254
Capital assets, net	32,398,393	-	32,398,393
Other assets	5,030,489	347,539	5,378,028
Total assets	118,691,606	441,069	119,132,675
Deferred Outflows of Resources	2,166,556	-	2,166,556
Total assets and deferred outflows of resources	<u>\$ 120,858,162</u>	<u>\$ 441,069</u>	<u>\$ 121,299,231</u>
Liabilities			
Current liabilities	\$ 64,999,978	\$ -	\$ 64,999,978
Noncurrent liabilities	16,824,270	-	16,824,270
Total liabilities	81,824,248	-	81,824,248
Net Position			
Net investment in capital assets	13,113,106	-	13,113,106
Restricted	3,263,070	-	3,263,070
Unrestricted	22,657,738	441,069	23,098,807
Total net position	39,033,914	441,069	39,474,983
Total liabilities and net position	<u>\$ 120,858,162</u>	<u>\$ 441,069</u>	<u>\$ 121,299,231</u>

	December 31, 2017		
	Hospital	Foundation	Total
Assets			
Current assets	\$ 66,409,262	\$ 42,412	\$ 66,451,674
Capital assets, net	32,626,401	-	32,626,401
Other assets	5,180,349	344,853	5,525,202
Total assets	104,216,012	387,265	104,603,277
Deferred Outflows of Resources	2,381,421	-	2,381,421
Total assets and deferred outflows of resources	<u>\$ 106,597,433</u>	<u>\$ 387,265</u>	<u>\$ 106,984,698</u>
Liabilities			
Current liabilities	\$ 58,236,679	\$ -	\$ 58,236,679
Noncurrent liabilities	18,728,934	-	18,728,934
Total liabilities	76,965,613	-	76,965,613
Net Position			
Net investment in capital assets	11,642,387	-	11,642,387
Restricted	3,236,331	-	3,236,331
Unrestricted	14,753,102	387,265	15,140,367
Total net position	29,631,820	387,265	30,019,085
Total liabilities and net position	<u>\$ 106,597,433</u>	<u>\$ 387,265</u>	<u>\$ 106,984,698</u>

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A Component Unit of Daviess County, Indiana

Notes to Financial Statements December 31, 2018 and 2017

The following tables include condensed combining statements of revenues, expenses and changes in net position information for the Hospital and its blended component unit for the years ended December 31, 2018 and 2017.

	December 31, 2018		
	Hospital	Foundation	Total
Operating Revenue			
Net patient service revenue	\$ 249,385,280	\$ -	\$ 249,385,280
Other operating revenue	42,376,726	-	42,376,726
Total operating revenue	<u>291,762,006</u>	<u>-</u>	<u>291,762,006</u>
Operating Expenses			
Salaries, wages, contract labor and employee benefits	136,430,541	-	136,430,541
Purchased services and professional fees	47,117,555	-	47,117,555
Depreciation and amortization	3,636,475	-	3,636,475
Other operating expenses	93,825,113	75,764	93,900,877
Total operating expenses	<u>281,009,684</u>	<u>75,764</u>	<u>281,085,448</u>
Operating Income (Loss)	<u>10,752,322</u>	<u>(75,764)</u>	<u>10,676,558</u>
Nonoperating Revenue (Expenses)			
Investment return	124,743	2,690	127,433
Interest expense	(1,513,964)	-	(1,513,964)
Noncapital grants and contributions	-	126,878	126,878
Other	38,993	-	38,993
	<u>(1,350,228)</u>	<u>129,568</u>	<u>(1,220,660)</u>
Increase in Net Position	<u>\$ 9,402,094</u>	<u>\$ 53,804</u>	<u>\$ 9,455,898</u>

	December 31, 2017		
	Hospital	Foundation	Total
Operating Revenue			
Net patient service revenue	\$ 214,054,817	\$ -	\$ 214,054,817
Other operating revenue	34,485,499	-	34,485,499
Total operating revenue	<u>248,540,316</u>	<u>-</u>	<u>248,540,316</u>
Operating Expenses			
Salaries, wages, contract labor and employee benefits	116,297,141	-	116,297,141
Purchased services and professional fees	37,701,130	-	37,701,130
Depreciation and amortization	3,588,170	-	3,588,170
Other operating expenses	82,241,679	67,274	82,308,953
Total operating expenses	<u>239,828,120</u>	<u>67,274</u>	<u>239,895,394</u>
Operating Income (Loss)	<u>8,712,196</u>	<u>(67,274)</u>	<u>8,644,922</u>
Nonoperating Revenue (Expenses)			
Investment return	78,276	166	78,442
Interest expense	(1,363,180)	-	(1,363,180)
Noncapital grants and contributions	-	85,068	85,068
Other	(581,949)	-	(581,949)
	<u>(1,866,853)</u>	<u>85,234</u>	<u>(1,781,619)</u>
Increase in Net Position	<u>\$ 6,845,343</u>	<u>\$ 17,960</u>	<u>\$ 6,863,303</u>

Daviess Community Hospital

A Component Unit of Daviess County, Indiana

Notes to Financial Statements **December 31, 2018 and 2017**

Note 15: Long-Term Care Operating Leases and Management Agreements

The Hospital has entered into various agreements to lease the facilities and equipment for the operation of thirty-seven long-term care nursing facilities. Along with the lease agreements, the Hospital also entered into management agreements with the facilities' previous managers (Managers) to continue to operate the facilities. The agreements expire at various times through September 2026 and include optional two to three-year extensions. The management agreements include optional termination clauses by either party if material changes in circumstances, as defined in the agreements, occur. The lease agreements include termination clauses where the leases shall automatically end at the termination of the management agreements between the Hospital and Managers.

The lease agreements call for monthly base rent payments as outlined in the agreements. Certain facilities include annual rent increases of 2% to 5%. Rental expense approximated \$23.9 million and \$11.6 million in 2018 and 2017, respectively.

The management agreements include management fees consisting of base management fees, subordinated management fees and incentive management fees. Base and subordinate management fees are determined on percentages of net patient service revenue of the individual facilities and range from 0.5% to 5.0%. Incentive management fees are to be paid out of the net earnings of the facility, if sufficient excess cash flows exist, up to the maximum amounts as defined in the agreement. The management agreements also call for quality, royalty and capital improvement fees to be paid to the Managers. Management and other fees approximated \$24.9 million and \$16.1 million in 2018 and 2017, respectively, and included fee reductions as insufficient cash flows existed to fund amounts due. Amounts are included in purchased services and professional fees on the statements of revenues, expenses and changes in net position.

Under the management agreements, the employees necessary to operate the facilities are contracted by the Hospital. The majority of all costs in the ordinary course of business are paid by the Managers who are then reimbursed by the Hospital from operations of the facilities. Similarly, Managers of certain facilities have provided working capital to cover insufficient cash flows from operations. Consequently, the majority of accounts payable and accrued expenses of the long-term care operations reflect amounts due to Managers or its vendors.

The Hospital has executed security agreements with lenders of certain Managers, allowing for a security interest in certain deposit and receivable accounts approximating \$13.5 million and \$7.8 million at December 31, 2018 and 2017.

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Notes to Financial Statements
December 31, 2018 and 2017

Note 16: Subsequent Events

In August 2019, the Hospital consolidated nursing home operations which included the closing of seven facilities. This change allows for improved care by allocating staff and resources to other facilities best utilized.

Note 17: Future Accounting Standards

In fiscal year 2020, the Hospital will implement GASB Statement No. 87, *Leases*. The statement provides a new framework for accounting for leases under the principal that leases are financings and lessees should recognize an intangible asset and a corresponding liability while the lessor will recognize a lease receivable and related deferred inflow of resources. The Hospital has not determined the impact of this new standard on its financial statements, however, it could have a material future impact.

In fiscal year 2020, the Hospital will implement GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*. This statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period it occurs rather than reporting as a part of the historical cost of a capital asset. The Hospital does not believe the impact of this new standard will be material to the financial statements.

Supplementary Information

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Combining Balance Sheet Information
December 31, 2018

	2018			
	Hospital	LTC	Hospital Foundation	Total
Current Assets				
Cash	\$ 1,119,794	\$ 34,744,420	\$ 93,530	\$ 35,957,744
Patient accounts receivable, net of allowance of \$10,219,126	7,700,772	19,042,504	-	26,743,276
Supplies	1,380,441	-	-	1,380,441
Prepaid expenses and other	1,080,591	15,670,202	-	16,750,793
Estimated amounts due from third-party payers	524,000	-	-	524,000
Total current assets	11,805,598	69,457,126	93,530	81,356,254
Noncurrent Cash and Investments				
Internally designated	104,600	-	347,539	452,139
Held by trustee for debt service	3,263,070	-	-	3,263,070
	3,367,670	-	347,539	3,715,209
Capital Assets, net	27,580,331	4,818,062	-	32,398,393
Other Assets	374,414	1,288,405	-	1,662,819
Deferred Outflows of Resources - debt defeasance costs	2,166,556	-	-	2,166,556
Total assets and deferred outflows of resources	\$ 45,294,569	\$ 75,563,593	\$ 441,069	\$ 121,299,231
Liabilities and Net Position				
Current Liabilities				
Current maturities of long-term debt	\$ 2,461,017	\$ -	\$ -	\$ 2,461,017
Line of credit	2,800,000	20,055,972	-	22,855,972
Accounts payable and accrued expenses	5,179,934	34,350,043	-	39,529,977
Estimated amounts due to third-party payers	153,012	-	-	153,012
Total current liabilities	10,593,963	54,406,015	-	64,999,978
Long-Term Debt	16,824,270	-	-	16,824,270
Total liabilities	27,418,233	54,406,015	-	81,824,248
Net Position				
Net investment in capital assets	8,295,044	4,818,062	-	13,113,106
Restricted for debt service	3,263,070	-	-	3,263,070
Unrestricted	6,318,222	16,339,516	441,069	23,098,807
Total net position	17,876,336	21,157,578	441,069	39,474,983
Total liabilities and net position	\$ 45,294,569	\$ 75,563,593	\$ 441,069	\$ 121,299,231

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Combining Balance Sheet Information
December 31, 2017

	2017			
	Hospital	LTC	Hospital Foundation	Total
Current Assets				
Cash	\$ 375,882	\$ 26,897,768	\$ 42,412	\$ 27,316,062
Patient accounts receivable, net of allowance of \$4,881,715	6,548,257	18,381,963	-	24,930,220
Supplies	1,424,962	-	-	1,424,962
Prepaid expenses and other	1,752,599	10,419,659	-	12,172,258
Estimated amounts due from third-party payers	608,172	-	-	608,172
Total current assets	10,709,872	55,699,390	42,412	66,451,674
Noncurrent Cash and Investments				
Internally designated	104,480	-	344,853	449,333
Held by trustee for debt service	3,236,331	-	-	3,236,331
	3,340,811	-	344,853	3,685,664
Capital Assets, net	28,742,053	3,884,348	-	32,626,401
Other Assets	295,927	1,543,611	-	1,839,538
Deferred Outflows of Resources - debt defeasance costs	2,381,421	-	-	2,381,421
Total assets and deferred outflows of resources	\$ 45,470,084	\$ 61,127,349	\$ 387,265	\$ 106,984,698
Liabilities and Net Position				
Current Liabilities				
Current maturities of long-term debt	\$ 2,255,080	\$ -	\$ -	\$ 2,255,080
Line of credit	3,400,000	14,072,288	-	17,472,288
Accounts payable and accrued expenses	8,608,276	29,742,035	-	38,350,311
Estimated amounts due to third-party payers	159,000	-	-	159,000
Total current liabilities	14,422,356	43,814,323	-	58,236,679
Long-Term Debt	18,728,934	-	-	18,728,934
Total liabilities	33,151,290	43,814,323	-	76,965,613
Net Position				
Net investment in capital assets	7,758,039	3,884,348	-	11,642,387
Restricted for debt service	3,236,331	-	-	3,236,331
Unrestricted	1,324,424	13,428,678	387,265	15,140,367
Total net position	12,318,794	17,313,026	387,265	30,019,085
Total liabilities and net position	\$ 45,470,084	\$ 61,127,349	\$ 387,265	\$ 106,984,698

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Combining Statement of Revenues, Expenses and
Changes in Net Position Information
Year Ended December 31, 2018

	2018			
	Hospital	LTC	Hospital Foundation	Total
Operating Revenues				
Net patient service revenue, net of provision for uncollectible accounts of \$9,824,179	\$ 58,856,549	\$ 190,528,731	\$ -	\$ 249,385,280
Other	1,262,345	41,114,381	-	42,376,726
Total operating revenues	60,118,894	231,643,112	-	291,762,006
Operating Expenses				
Salaries, wages and contract labor	25,127,963	91,637,472	-	116,765,435
Employee benefits	5,488,083	14,177,023	-	19,665,106
Purchased services and professional fees	9,177,226	37,940,329	-	47,117,555
Supplies	7,240,154	16,047,253	-	23,287,407
Insurance	483,140	3,185,372	-	3,668,512
Utilities	999,163	5,490,087	-	6,489,250
Rent	253,517	26,548,869	-	26,802,386
Repairs and maintenance	4,389,716	2,437,947	-	6,827,663
Provider hospital assessment fee	3,450,469	-	-	3,450,469
Depreciation and amortization	3,024,466	612,009	-	3,636,475
Other	1,707,204	21,592,222	75,764	23,375,190
Total operating expenses	61,341,101	219,668,583	75,764	281,085,448
Operating Income (Loss)	(1,222,207)	11,974,529	(75,764)	10,676,558
Nonoperating Revenues (Expenses)				
Investment income	124,743	-	2,690	127,433
Interest expense	(1,513,964)	-	-	(1,513,964)
Noncapital grants and contributions	-	-	126,878	126,878
Other	38,993	-	-	38,993
Total nonoperating revenues (expenses)	(1,350,228)	-	129,568	(1,220,660)
Excess (Deficiency) of Revenues Over Expenses Before Transfers	(2,572,435)	11,974,529	53,804	9,455,898
Transfers	8,129,977	(8,129,977)	-	-
Increase in Net Position	5,557,542	3,844,552	53,804	9,455,898
Net Position, Beginning of Year	12,318,794	17,313,026	387,265	30,019,085
Net Position, End of Year	\$ 17,876,336	\$ 21,157,578	\$ 441,069	\$ 39,474,983

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Combining Statement of Revenues, Expenses and
Changes in Net Position Information
Year Ended December 31, 2017

	2017			
	Hospital	LTC	Hospital Foundation	Total
Operating Revenues				
Net patient service revenue, net of provision for uncollectible accounts of \$5,929,531	\$ 53,887,537	\$ 160,167,280	\$ -	\$ 214,054,817
Other	948,685	33,536,814	-	34,485,499
Total operating revenues	<u>54,836,222</u>	<u>193,704,094</u>	<u>-</u>	<u>248,540,316</u>
Operating Expenses				
Salaries, wages and contract labor	24,243,385	73,256,856	-	97,500,241
Employee benefits	5,533,992	13,262,908	-	18,796,900
Purchased services and professional fees	9,221,201	28,479,929	-	37,701,130
Supplies	7,100,463	13,788,847	-	20,889,310
Insurance	481,069	2,022,801	-	2,503,870
Utilities	995,881	4,491,947	-	5,487,828
Rent	366,467	22,132,453	-	22,498,920
Repairs and maintenance	3,217,693	2,089,050	-	5,306,743
Provider hospital assessment fee	2,808,515	-	-	2,808,515
Depreciation and amortization	3,273,961	314,209	-	3,588,170
Other	1,776,724	20,969,769	67,274	22,813,767
Total operating expenses	<u>59,019,351</u>	<u>180,808,769</u>	<u>67,274</u>	<u>239,895,394</u>
Operating Income (Loss)	<u>(4,183,129)</u>	<u>12,895,325</u>	<u>(67,274)</u>	<u>8,644,922</u>
Nonoperating Revenues (Expenses)				
Investment income	78,276	-	166	78,442
Interest expense	(1,363,180)	-	-	(1,363,180)
Noncapital grants and contributions	-	-	85,068	85,068
Other	(581,949)	-	-	(581,949)
Total nonoperating revenues (expenses)	<u>(1,866,853)</u>	<u>-</u>	<u>85,234</u>	<u>(1,781,619)</u>
Excess (Deficiency) of Revenues Over Expenses Before Transfers	<u>(6,049,982)</u>	<u>12,895,325</u>	<u>17,960</u>	<u>6,863,303</u>
Transfers	<u>2,747,848</u>	<u>(2,747,848)</u>	<u>-</u>	<u>-</u>
Increase (Decrease) in Net Position	<u>(3,302,134)</u>	<u>10,147,477</u>	<u>17,960</u>	<u>6,863,303</u>
Net Position, Beginning of Year	<u>15,620,928</u>	<u>7,165,549</u>	<u>369,305</u>	<u>23,155,782</u>
Net Position, End of Year	<u>\$ 12,318,794</u>	<u>\$ 17,313,026</u>	<u>\$ 387,265</u>	<u>\$ 30,019,085</u>

**Report on Internal Control Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements Performed
in Accordance With Government Auditing Standards**

Independent Auditor's Report

Board of Governors
Daviess Community Hospital
Washington, Indiana

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Daviess Community Hospital (Hospital), a component unit of Daviess County, Indiana, which comprise the balance sheet as of December 31, 2018, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 25, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Hospital's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as item 2018-001 that we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hospital's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Hospital's Response to Findings

The Hospital's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Hospital's response was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Indianapolis, Indiana
November 25, 2019

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Schedule of Findings and Responses
Year Ended December 31, 2018

Reference Number	Finding
2018-001	Criteria or Specific Requirement: Internal Control Over Financial Reporting Condition: The Hospital did not timely receive or review periodic financial reporting of the nursing home operations as prepared by the third-party managers. Effect: Routine monitoring of the operations of the nursing homes is imperative to ensure that the Hospital is exercising its fiduciary and regulatory responsibility. Potential misstatements in the financial statements could occur and not be detected and/or corrected in a timely manner. Cause: While financial statements were prepared and monitored by the third-party managers, they were not routinely or timely provided to Hospital management for inclusion in the Hospital's financial statements. Adjustments were required to information provided by third-party managers to appropriately reflect the operations of the nursing homes. Recommendation: We recommend that the Hospital obtain and review periodic financial statements of each of the nursing homes and review internal calculations of amounts due under management agreements. Financial information should be included in Hospital financial statements on a routine basis. Views of Responsible Officials and Planned Corrective Action: We concur. Management continues to evaluate current controls related to accounting for the nursing home operations to ensure that transactions are accounted for properly and in a timely manner.