

Hutchinson Regional Medical Center, Inc.

Independent Auditor's Report and Consolidated Financial Statements

June 30, 2017 and 2016



Hutchinson Regional Medical Center, Inc.
June 30, 2017 and 2016

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Independent Auditor's Report

Board of Directors
Hutchinson Regional Medical Center, Inc.
Hutchinson, Kansas

We have audited the accompanying consolidated financial statements of Hutchinson Regional Medical Center, Inc. (Medical Center), which comprise the balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hutchinson Regional Medical Center, Inc. as of June 30, 2017 and 2016, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Consolidating Schedule – Balance Sheet, Consolidating Schedule – Statement of Operations and Consolidating Schedule – Statement of Changes in Net Assets listed in the table of contents are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

BKD, LLP

Wichita, Kansas
October 20, 2017

Hutchinson Regional Medical Center, Inc.
Consolidated Balance Sheets
June 30, 2017 and 2016

Assets

	<u>2017</u>	<u>2016</u>
Current Assets		
Cash and cash equivalents	\$ 33,079,646	\$ 26,618,264
Assets limited as to use, current	1,963,282	2,264,267
Funds held on deposit with the Hutchinson Regional Medical Foundation	6,393,550	5,645,582
Patient accounts receivable, net of allowance; 2017 - \$14,157,818, 2016 - \$12,903,061	34,031,014	32,283,391
Other receivables	1,196,667	1,448,896
Net investment in direct financing leases	1,203,475	1,228,172
Supplies	5,091,431	4,291,215
Prepaid expenses and other	<u>2,970,835</u>	<u>2,858,924</u>
Total current assets	<u>85,929,900</u>	<u>76,638,711</u>
Assets Limited As To Use		
Internally designated		
For capital improvements	23,565,115	27,134,872
For self-funded employee health, workers' compensation and professional liability insurance	5,999,555	6,035,245
Interests in net assets of foundations	<u>32,057,911</u>	<u>28,862,395</u>
	61,622,581	62,032,512
Less amount required to meet current obligations	<u>1,963,282</u>	<u>2,264,267</u>
	<u>59,659,299</u>	<u>59,768,245</u>
Property and Equipment, Net	<u>64,205,038</u>	<u>54,663,408</u>
Other Assets		
Net investment in direct financing leases	17,288,695	18,088,633
Long-term investments	84,831,645	54,439,324
Other	<u>24,465</u>	<u>24,465</u>
	<u>102,144,805</u>	<u>72,552,422</u>
Total assets	<u>\$ 311,939,042</u>	<u>\$ 263,622,786</u>

Liabilities and Net Assets

	<u>2017</u>	<u>2016</u>
Current Liabilities		
Current maturities of long-term debt	\$ 720,000	\$ 1,250,000
Current maturities of capital lease obligations	57,113	56,403
Accounts payable	7,346,552	5,701,935
Accrued expenses	9,012,773	8,697,118
Deferred revenue	2,971	8,455
Estimated amounts due to third-party payers	<u>818,437</u>	<u>870,874</u>
Total current liabilities	17,957,846	16,584,785
Long-term Debt	36,290,227	4,883,891
Capital Lease Obligations	<u>143,769</u>	<u>203,867</u>
Total liabilities	<u>54,391,842</u>	<u>21,672,543</u>
Net Assets		
Unrestricted	226,814,770	214,189,257
Temporarily restricted	30,681,824	27,760,986
Permanently restricted	<u>50,606</u>	<u>-</u>
Total net assets	<u>257,547,200</u>	<u>241,950,243</u>
Total liabilities and net assets	<u>\$ 311,939,042</u>	<u>\$ 263,622,786</u>

Hutchinson Regional Medical Center, Inc.
Consolidated Statements of Operations
Years Ended June 30, 2017 and 2016

	2017	2016
Unrestricted Revenues, Gains and Other Support		
Net patient service revenue	\$ 161,014,143	\$ 150,447,526
Provision for uncollectible accounts	17,990,944	15,557,092
Net patient service revenue less provision for uncollectible accounts	143,023,199	134,890,434
Electronic health records incentive	13,385	492,530
Other	6,649,130	6,793,914
Net assets released from restriction used for operations	183,424	106,438
Total unrestricted revenues, gains and other support	149,869,138	142,283,316
Expenses and Losses		
Salaries and wages	56,158,412	54,596,373
Employee benefits	14,500,202	14,720,832
Purchased services, supplies and other	67,576,644	62,202,024
Depreciation and amortization	8,268,377	8,381,164
Income tax expense	120,518	264,000
Interest	142,711	101,867
Total expenses and losses	146,766,864	140,266,260
Operating Income	3,102,274	2,017,056
Other Income		
Investment return	8,912,583	(473,302)
Contributions received	295,662	333,198
Insurance recoveries	109,617	493,254
Other	192,476	972,896
Total other income	9,510,338	1,326,046
Excess of Revenues Over Expenses	12,612,612	3,343,102
Investment return - change in unrealized gains (losses) on other than trading securities	(22,673)	2,522
Net assets released from restriction used for purchase of property and equipment	35,574	25,227
Increase in Unrestricted Net Assets	\$ 12,625,513	\$ 3,370,851

Hutchinson Regional Medical Center, Inc.
Consolidated Statements of Changes in Net Assets
Years Ended June 30, 2017 and 2016

	2017	2016
Unrestricted Net Assets		
Excess of revenues over expenses	\$ 12,612,612	\$ 3,343,102
Investment return - change in unrealized gains (losses) on other than trading securities	(22,673)	2,522
Net assets released from restriction used for purchase of property and equipment	35,574	25,227
Increase in unrestricted net assets	12,625,513	3,370,851
Temporarily Restricted Net Assets		
Contributions received	167,743	152,085
Change in interests in net assets of foundations	3,012,438	(159,587)
Net assets released from restrictions used for operations	(183,424)	(106,438)
Net assets released from restrictions used for purchase of property and equipment	(35,574)	(25,227)
Reclassification of net assets	(40,345)	-
Increase (decrease) in temporarily restricted net assets	2,920,838	(139,167)
Permanently Restricted Net Assets		
Contributions received	10,261	-
Reclassification of net assets	40,345	-
Increase in permanently restricted net assets	50,606	-
Change in Net Assets	15,596,957	3,231,684
Net Assets, Beginning of Year	241,950,243	238,718,559
Net Assets, End of Year	\$ 257,547,200	\$ 241,950,243

Hutchinson Regional Medical Center, Inc.
Consolidated Statements of Cash Flows
Years Ended June 30, 2017 and 2016

	2017	2016
Operating Activities		
Change in net assets	\$ 15,596,957	\$ 3,231,684
Items not requiring (providing) operating cash flow		
Gain on sale of property and equipment	-	(852,650)
Depreciation	8,268,377	8,381,164
Amortization of bond issuance costs	11,196	9,797
Provision for uncollectible accounts	17,990,944	15,557,092
Restricted contributions	(167,743)	(152,085)
Net assets released from restriction used for purchase of property and equipment	(35,574)	(25,227)
Change in unrealized and realized (gains) losses on investments	(6,771,756)	2,344,795
Equity in income of uncombined affiliate	(22,673)	2,522
Change in interests in net assets of foundations	(3,012,438)	159,587
Changes in		
Patient accounts receivable	(19,738,567)	(22,411,835)
Other receivables	252,229	(349,616)
Supplies	(800,216)	(143,676)
Prepaid expenses and other	(111,911)	(766,073)
Estimated amounts due from and to third-party payers	(52,437)	137,058
Accounts payable	549,927	(271,099)
Accrued expenses	315,655	(1,739,491)
Other liabilities	(5,484)	3,497
	<u>12,266,486</u>	<u>3,115,444</u>
Net cash provided by operating activities		
Investing Activities		
Purchase of investments	(20,211,213)	(2,443,987)
Proceeds from disposition of investments	35,690	245,169
Change in funds held on deposit with the Hutchinson Regional Medical Foundation	(747,968)	(859,962)
Purchase of property and equipment	(16,726,525)	(4,086,168)
Proceeds from sale of property and equipment	-	946,357
Principal payments received on leases	1,193,102	1,231,297
Direct financing leases funded	(387,154)	(70,803)
Proceeds from disposition of leased assets	18,687	11,799
	<u>(36,825,381)</u>	<u>(5,026,298)</u>
Net cash used in investing activities		

Hutchinson Regional Medical Center, Inc.
Consolidated Statements of Cash Flows (Continued)
Years Ended June 30, 2017 and 2016

	2017	2016
Financing Activities		
Proceeds from issuance of long-term debt	\$ 43,443,028	\$ -
Restricted contributions	167,743	152,085
Principal payments on long-term debt	(12,145,087)	(1,180,000)
Principal payments on capital lease obligations	(59,388)	(53,281)
Bond issuance costs paid	(421,593)	-
Net assets released from restrictions used for purchase of property and equipment	35,574	25,227
Net cash provided by (used in) financing activities	31,020,277	(1,055,969)
Increase (Decrease) in Cash and Cash Equivalents	6,461,382	(2,966,823)
Cash and Cash Equivalents, Beginning of Year	26,618,264	29,585,087
Cash and Cash Equivalents, End of Year	\$ 33,079,646	\$ 26,618,264
Supplemental Cash Flows Information		
Purchases of property and equipment in accounts payable	\$ 1,584,773	\$ 490,083
Capital lease obligation incurred for property and equipment	\$ -	\$ 287,042
Interest paid (net of amount capitalized)	\$ 131,515	\$ 101,867
Income taxes paid	\$ 126,728	\$ 337,064

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

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

Nature of Operations

Hutchinson Regional Medical Center, Inc. (Medical Center) is a Kansas not-for-profit membership corporation organized for the purpose of owning and operating a health care facility located in Hutchinson, Kansas. The Medical Center is the sole member or sole shareholder of the following corporations:

Not-for-profit
Horizons Mental Health Center, Inc. (HMHC)
Main Line, Inc. (Main Line)
Hospice of Reno County, Inc. (HoRC)
The Living Center, Inc. (TLC)

For profit
Hutchinson Health Care Services, Inc. (HHCSI)

The Living Center, Inc. ceased operations in November 2016.

Principles of Consolidation

The consolidated financial statements of Hutchinson Regional Medical Center, Inc. (Healthcare System) include the accounts of the Medical Center and its wholly-owned or controlled corporate entities. All of the corporate entities in the Healthcare System were organized under the laws of the State of Kansas and are under common control and management. Significant intercompany accounts and transactions have been eliminated.

Use of Estimates

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

Cash and Cash Equivalents

The Healthcare System considers all liquid investments with original maturities of three months or less to be cash equivalents, except for assets limited as to use by either Board designation or other arrangements. At June 30, 2017 and 2016, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

At June 30, 2017, the Healthcare System's cash accounts, including assets limited as to use by either Board designation or other arrangements, exceeded federally insured limits by approximately \$35,823,000.

Investments and Investment Return

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments.

Funds held on deposit are managed by the Foundation in a pooled investment account in order to maximize investment returns. The Foundation has agreed to pay interest on these funds at the Foundation's average rate of return on its pooled investment portfolio. The funds are due on demand without any limitations on withdrawals. Interest in the Foundation investment pool is valued based on estimates of the net asset value of the investment pool as provided by the Foundation.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in unrestricted net assets. Other investment return is reflected in the statements of operations and changes in net assets as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

Assets Limited As To Use

Assets limited as to use include (1) assets set aside by the Board of Directors (Board) for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes, (2) assets set aside by the Board under self-insurance arrangements for employee health, workers' compensation and professional liability insurance, and (3) beneficial interest in net assets of the Foundation and Hutchinson Community Foundation (HCF). Amounts required to meet current liabilities of the Healthcare System are included in current assets.

Patient Accounts Receivable

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Healthcare System analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for uncollectible accounts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

For receivables associated with services provided to patients who have third-party coverage, the Healthcare System analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for uncollectible accounts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Healthcare System records a significant provision for uncollectible accounts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated or provided by policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Healthcare System's allowance for doubtful accounts for self-pay patients was 58% of self-pay accounts receivable at June 30, 2017, and 83% of self-pay accounts receivable at June 30, 2016. In addition, the Healthcare System's write-offs were approximately \$16,400,000 and \$16,800,000 for the years ended June 30, 2017 and 2016, respectively.

Supplies

The Healthcare System states supply inventories at the lower of cost, determined using the first-in, first-out method, or market.

Net Investment in Direct Financing Leases

Main Line leases substantially all of its assets to local physician groups or other related health care entities. It has also constructed buildings and acquired equipment, most which are leased. The majority of the leases are accounted for as direct financing leases and are based upon the original cost of the asset.

Net investment in direct financing leases are reported at their outstanding unpaid principal balances. Interest income is accrued on the unpaid principal balance. Main Line charges off leases when collection of interest or principal becomes doubtful. There were no leases charged off during the years ended June 30, 2017 and 2016.

Property and Equipment

Property and equipment acquisitions are recorded at cost and are depreciated 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.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

Land improvements	10-20 years
Buildings	5-40 years
Equipment	3-15 years

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

The Healthcare System capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. Total interest capitalized and incurred was:

	<u>2017</u>	<u>2016</u>
Total interest expense incurred on borrowings for project	\$ 815,118	\$ -
Interest income from investment of proceeds of borrowings for project	<u>(27,702)</u>	<u>-</u>
Net interest cost capitalized	<u>\$ 787,416</u>	<u>\$ -</u>
Interest capitalized	\$ 787,416	\$ -
Interest charged to expense	<u>142,711</u>	<u>101,867</u>
Total interest incurred	<u>\$ 930,127</u>	<u>\$ 101,867</u>

Long-lived Asset Impairment

The Healthcare System evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized for the years ended June 30, 2017 and 2016.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

Interests in Net Assets of Foundations

The Healthcare System and the Foundation are financially interrelated organizations. The Foundation seeks private support for and holds net assets on behalf of the Healthcare System. The Healthcare System accounts for its interest in the net assets of the Foundation (Interest) in a manner similar to the equity method. Changes in the Interest are included in change in net assets. Transfers of assets between the Foundation and the Healthcare System are recognized as increases or decreases in the Interest.

The Healthcare System is also the beneficiary of funds held by HCF. The Healthcare System recognizes as an asset its interest in the net assets held by HCF for the benefit of the Healthcare System and adjusts this interest for changes in the net assets held by HCF occurring during the reporting period.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Healthcare System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Healthcare System in perpetuity.

Net Patient Service Revenue

The Healthcare System has agreements with third-party payers that provide for payments to the Healthcare System 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. 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 Healthcare System provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Healthcare System does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. The Healthcare System's direct and indirect costs for services and supplies furnished under the Healthcare System's charity care policy totaled approximately \$801,000 and \$553,000 in 2017 and 2016, respectively. Costs were calculated using the overall cost-to-charge ratio from the June 30, 2016 and 2015, filed Medicare cost reports, respectively. The June 30, 2017, Medicare cost report was not yet filed as of the date the consolidated financial statements were available to be issued.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

Contributions

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

Self-insurance

The Healthcare System self-insures its medical and dental benefits for all eligible employees and dependents and is funded by both employer and employee contributions. The Healthcare System contracts with third-party administrators to provide claims management services. The Healthcare System purchases third-party insurance coverage for certain excess claims and accrues a liability for settling reported and unreported claims as of the balance sheet date.

The Healthcare System also self-insures a portion of its workers' compensation and professional liability claims risk and accrues a liability for the estimated cost of settling all reported and unreported claims as of the balance sheet date. The Healthcare System contracts with third-party administrators to provide claims management services. The Healthcare System has commercial stop-loss coverage through third-party insurance companies which provides additional coverage for workers' compensation and professional liability claims.

Income Taxes

The Medical Center and its not-for-profit affiliates have been recognized as exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and a similar provision of state law. However, the Healthcare System is subject to federal income tax on any unrelated business taxable income. HHCSI is a taxable corporation which pays taxes at prevailing corporate rates.

The Healthcare System files tax returns in the U.S. federal jurisdiction.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

Excess of Revenues Over Expenses

The consolidated statements of operations include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments other-than-trading securities and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

Transfers Between Fair Value Hierarchy Levels

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the actual transfer date.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records (EHR) technology. Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the Healthcare System continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Healthcare System recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

The Healthcare System has recorded revenue of \$13,385 and \$492,530 for 2017 and 2016, respectively, which is included in electronic health records incentive within unrestricted revenues, gains and other support in the consolidated statements of operations.

Reclassifications

Certain reclassifications have been made to the 2016 consolidated financial statements for the adoption of ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, that were deemed to be immaterial to conform to the 2017 consolidated financial statement presentation. Other reclassifications have been made to the 2016 consolidated financial statements to conform to the 2017 consolidated financial statement presentation. These reclassifications had no effect on the change in net assets.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

Note 2: Net Patient Service Revenue

The Healthcare System recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Healthcare System recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Healthcare System's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Healthcare System records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided. This provision for uncollectible accounts is presented on the consolidated statements of operations as a component of net patient service revenue.

The Healthcare System has agreements with third-party payers that provide for payments to the Healthcare System 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. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. The Healthcare System is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Healthcare System and audits thereof by the Medicare administrative contractor.

Medicaid. Inpatient acute care services rendered to Medicaid 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. All other services rendered to Medicaid beneficiaries are paid at prospective rates determined on either a per diem or a fee-for-service basis.

The Kansas Medicaid plan includes provisions for a provider assessment program. Under that program, all hospitals, other than critical access hospitals, pay an assessment. The program then distributes the assessments and additional federal monies to Kansas Medicaid providers. Assessments incurred under the program are included in operating expenses. Distributions received from the program are included in net patient service revenue.

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.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

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

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the years ended June 30, 2017 and 2016, respectively, was approximately:

	<u>2017</u>	<u>2016</u>
Medicare	\$ 70,997,212	\$ 66,880,876
Medicaid	19,461,551	18,707,512
Other third-party payers	52,322,002	45,098,250
Self-pay	<u>18,233,378</u>	<u>19,760,888</u>
Total	<u>\$ 161,014,143</u>	<u>\$ 150,447,526</u>

Note 3: Concentration of Credit Risk

Approximately \$35,823,000 of the Healthcare System's bank deposits were in excess of FDIC insurance limits as of June 30, 2017. The Healthcare System also invests funds in repurchase agreements and money market accounts with various banks which are generally collateralized by or invested in U.S. government or other highly liquid securities. The total of these other liquid asset investments was approximately \$3,170,000 as of June 30, 2017. While not insured or guaranteed by the U.S. government, management believes the credit risk related to these other liquid asset investments is minimal.

Main Line's direct financing leases are all either directly with Hutchinson Clinic or indirectly with companies majority-owned by Hutchinson Clinic.

The Healthcare System grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of net receivables from patients and third-party payers at June 30, 2017 and 2016, is:

	<u>2017</u>	<u>2016</u>
Medicare	54%	55%
Medicaid	2%	3%
Commercial	9%	10%
Blue Cross	9%	12%
Private pay	<u>26%</u>	<u>20%</u>
	<u>100%</u>	<u>100%</u>

Hutchinson Regional Medical Center, Inc.
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Note 4: Investments and Investment Return

Assets Limited As To Use

Assets limited as to use at June 30 include:

	<u>2017</u>	<u>2016</u>
For capital improvements		
Money market accounts	\$ 474,147	\$ 1,007,201
Equity investments		
Common stock	181,749	-
Mutual funds	12,366,714	12,636,010
International mutual funds	2,684,702	2,940,495
Fixed income investments		
Mortgage	143,180	206,278
Treasury and agencies	785,997	1,184,384
Asset-backed	402,254	357,512
Municipal bonds	155,697	189,950
Preferred stock	-	32,909
International bonds	330,335	40,180
Tax exempt general obligations	30,544	31,234
Bond mutual funds	3,822,074	5,967,746
Corporate bonds	1,422,687	1,601,100
Alternative investments (mutual funds)		
Hedge mutual funds	447,575	656,768
Infrastructure mutual funds	219,780	157,199
Traded real estate mutual funds	79,468	110,102
Accrued interest	18,212	15,804
	<u>\$ 23,565,115</u>	<u>\$ 27,134,872</u>
	<u>2017</u>	<u>2016</u>
For self-funded employee health, workers' compensation and professional liability insurance		
Money market accounts	\$ 1,312,331	\$ 1,474,423
Fixed income investments		
Treasury and agencies	4,660,138	4,533,231
Bond mutual funds	27,086	27,591
	<u>\$ 5,999,555</u>	<u>\$ 6,035,245</u>

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The Foundation was organized as a separate not-for-profit corporation in 1979, dedicated to the support of the Medical Center and its not-for-profit affiliates. The Medical Center's two predecessor operating entities transferred their interest as beneficiaries in certain estates to the Foundation in 1979. The Foundation's operations are managed by a Board of Directors (separate from the Board of Directors of the Medical Center) comprised of former board members of the Medical Center and its not-for-profit affiliates.

The following is a summary of the assets, liabilities, net assets, revenues, expenses, and changes in net assets of the Foundation as of June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Cash and investments	\$ 37,418,826	\$ 33,641,380
Other assets	5,358	6,119
	<u>\$ 37,424,184</u>	<u>\$ 33,647,499</u>
Accounts payable	\$ 40,951	\$ 15,771
Assets held under agency agreement	6,770,475	6,031,408
Net assets		
Unrestricted	28,762,301	25,854,861
Temporarily restricted	1,821,207	1,716,574
Permanently restricted	29,250	28,885
	<u>\$ 37,424,184</u>	<u>\$ 33,647,499</u>
	<u>2017</u>	<u>2016</u>
Revenues, Gains and Other Support		
Contributions	\$ 46,883	\$ 76,223
Net investment income	875,541	1,339,804
Net change in unrealized gains (losses) on investments	2,260,147	(1,427,739)
Income from mineral interests	26,570	59,349
	<u>3,209,141</u>	<u>47,637</u>
Expenses and Losses		
Other	499,076	338,951
	<u>499,076</u>	<u>338,951</u>
Other Changes	<u>197,375</u>	<u>-</u>
Change in Unrestricted Net Assets	2,907,440	(291,314)
Change in Temporarily Restricted Net Assets	104,633	127,842
Changes in Permanently Restricted Net Assets	365	3,885
Change in Net Assets	<u>\$ 3,012,438</u>	<u>\$ (159,587)</u>

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HoRC transferred assets to HCF to establish the Hospice of Reno County Fund (Fund) and designated HoRC as the beneficiary of the Fund. HCF invests the assets and allocates investment earnings and administration fees to the Fund. HoRC controls any distributions from the Fund as directed by the HoRC Board of Directors. The net assets of the Fund at June 30, 2017 and 2016, were \$1,445,153 and \$1,262,075, respectively, and are included in interests in net assets of foundations. The change in the net assets of the Fund for the years ended June 30, 2017 and 2016, was an increase of \$183,078 and \$12,482, respectively, and is included in other income in the consolidated statements of operations.

Long-term Investments

Long-term investments at June 30 include:

	<u>2017</u>	<u>2016</u>
Money market accounts	\$ 17,488,428	\$ 2,075,847
Equity investments		
Mutual funds	23,631,532	20,275,442
Common stock	3,801,441	2,656,041
International common stock	278,192	299,866
International mutual fund	7,641,584	5,837,302
Fixed income investments		
Mortgage	408,353	383,376
Treasury and agencies	9,570,863	460,542
Asset-backed	526,270	586,529
Municipal bonds	235,748	282,216
Preferred stock	-	67,414
International bonds	123,166	279,752
Bond mutual funds	8,230,389	8,213,018
Tax exempt general obligations	40,726	41,645
Corporate bonds	6,570,357	6,670,214
Government bonds	3,570,334	3,642,544
Alternative investments (mutual funds)		
Hedge mutual funds	1,162,202	1,345,735
Infrastructure mutual funds	563,558	313,496
Traded real estate mutual funds	202,773	222,616
Investment in HASC	20,000	20,000
Investment in Bladon	621,142	621,142
Investment in VHA	144,587	144,587
	<u>\$ 84,831,645</u>	<u>\$ 54,439,324</u>

The Medical Center has a 20% interest in Hutchinson Ambulatory Surgical Center LLC (HASC), a 13.30% interest in Bladon Dialysis, LLC (Bladon), and preferred stock of Voluntary Hospitals of America, Inc. (VHA). The Medical Center accounts for its investment in HASC and Bladon under the cost method. The VHA preferred stock will be redeemed by VHA for \$186,000 in August 2019 and is carried at its estimated net present value.

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The surgical facility's building and equipment are leased from Main Line (see *Note 6*). The net investment in the two leases is \$990,981 and \$1,374,134 at June 30, 2017 and 2016, respectively. Leasing income for these two leases was \$80,927 and \$109,817 for the years ended June 30, 2017 and 2016, respectively.

Total investment return is comprised of the following:

	<u>2017</u>	<u>2016</u>
Interest and dividend income	\$ 2,118,154	\$ 1,874,015
Unrealized gains (losses) on trading securities	6,470,344	(2,507,031)
Realized gains on trading securities	324,085	159,714
Unrealized gains (losses) on investments other than trading securities	(22,673)	2,522
	<u>\$ 8,889,910</u>	<u>\$ (470,780)</u>

The following table presents the Healthcare System's investments that represent 5% or more of the total investments (assets limited as to use and long-term investments) noted above:

	<u>2017</u>	<u>2016</u>
Investments at Fair Value		
iShares Core S&P 500 ETF	* \$ 4,671,525	\$ 3,909,406

*Investment represented 5% or more of the total investments in the individual year as indicated.

Note 5: Property and Equipment

Property and equipment at June 30 are summarized as follows:

	<u>2017</u>	<u>2016</u>
Land	\$ 1,839,225	\$ 1,839,225
Land improvements	4,817,405	4,792,139
Buildings	74,286,223	73,887,262
Building service equipment	32,870,202	32,806,793
Fixed equipment	7,825,972	7,719,793
Major movable equipment	94,045,670	90,560,423
	<u>215,684,697</u>	<u>211,605,635</u>
Less accumulated depreciation	164,816,175	158,223,437
	<u>50,868,522</u>	<u>53,382,198</u>
Construction in progress	13,336,516	1,281,210
	<u>13,336,516</u>	<u>1,281,210</u>
Property and equipment, net	<u>\$ 64,205,038</u>	<u>\$ 54,663,408</u>

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Construction in progress at June 30, 2017, consists primarily of costs incurred to date to remodel the intensive care unit (ICU), upgrade the emergency power system, and replace and upgrade various information technology hardware and software at the Medical Center. Contracts of approximately \$17,628,000 exist for those projects. At June 30, 2017, the remaining commitments on these contracts was approximately \$11,427,000. Commitments will be paid for with proceeds from the 2016 Revenue Bonds (see *Note 7*).

Note 6: Net Investment in Direct Financing Leases

The master facilities lease entered into during 1998 with Hutchinson Clinic expires June 30, 2028. The lessee may extend the lease for five years beyond any expiration date. The lessee may also purchase the building at fair value at any time. In November 2005, a supplement to the master facilities lease was executed. The supplement lease covers a medical office building completed in March 2006 and expires on March 1, 2036.

The building lease with the ambulatory surgery center expires March 31, 2021. The lessee may extend the lease for five years beyond any expiration date. The lessee may also purchase the building at fair value at any time.

The master equipment lease entered into during 1998 with Hutchinson Clinic expired June 30, 2003. The lessee has exercised options to extend the lease for an additional five-year term with the current lease expiring on June 30, 2018. The lessee may also purchase the leased equipment at fair value at any time.

The master equipment lease with the ambulatory surgery center expired December 31, 2013. The lessee has exercised its option to extend the lease for another five years with the current lease expiring December 31, 2018. The lessee may also purchase the leased equipment at fair value at any time. Main Line is required to provide an allowance to the lessee for additional equipment purchased as the lessee desires, not to exceed \$200,000 per year for a period not to exceed five years, unless the parties shall otherwise agree, for the purpose of purchasing or otherwise acquiring such additional equipment to be leased to the ambulatory surgery center pursuant to the terms and conditions of the lease.

Monthly payments are adjusted to reflect amounts expended by Main Line for building improvements and equipment acquisitions after inception of the leases. Main Line's net investment in direct financing leases that was used for new building construction, building improvements and equipment acquisitions added to the property subject to these leases, increased by \$387,154 and \$70,803, respectively, during 2017 and 2016.

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The following lists the components of the net investment in direct financing leases:

	<u>2017</u>	<u>2016</u>
Total minimum lease payments to be received	\$ 27,717,914	\$ 29,741,815
Unguaranteed equipment residual values	44,904	99,946
Unearned leasing income	<u>(9,270,648)</u>	<u>(10,524,956)</u>
	18,492,170	19,316,805
Less current maturities	<u>1,203,475</u>	<u>1,228,172</u>
Net investment, excluding current maturities	<u>\$ 17,288,695</u>	<u>\$ 18,088,633</u>

Minimum lease payments to be received during future fiscal years are as follows:

2018	\$ 2,443,922
2019	2,372,383
2020	2,351,822
2021	2,349,855
2022	2,308,664
Thereafter	<u>15,891,268</u>
	<u>\$ 27,717,914</u>

Note 7: Long-term Debt and Capital Lease Obligations

Long-term debt and capital lease obligations are summarized as follows:

	<u>2017</u>	<u>2016</u>
Florida Health Care Facility Loan Program (A)	\$ -	\$ 6,145,087
Series 2016 Revenue Bonds (B)	36,520,000	-
Capital lease obligations (C)	<u>200,882</u>	<u>260,270</u>
	36,720,882	6,405,357
Add: Unamortized bond premium	903,029	-
Less: Unamortized bond issuance costs	(412,802)	(11,196)
Less: Current maturities	<u>(777,113)</u>	<u>(1,306,403)</u>
	<u>\$ 36,433,996</u>	<u>\$ 5,087,758</u>

- (A) In December 2000, the Medical Center entered into a loan agreement to borrow up to \$30,000,000 under a participating loan program funded through the Florida Health Care Facility Loan Program. Principal and interest is payable monthly through November 2020. The loan bears interest at a variable rate equal to the monthly Bond Market Association Municipal Swap Index plus an adjustment for ongoing fees and expenses (1.59% as of June 30, 2016). The Medical Center used the funds to purchase property and equipment. The loan was paid off in full during 2017.

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The Medical Center's loan agreement contained various restrictive covenants, including, but not limited to, a minimum required level of days cash on hand, a minimum required debt service ratio, a minimum required capitalization ratio, restrictions on incurrence of additional debt, restrictions on disposition of property and equipment and restrictions on transfers of cash other than for payment of operating costs or debt service.

- (B) In December 2016, the Medical Center issued Series 2016 Hospital Facilities Revenue Bonds in the amount of \$36,520,000. Principal is payable annually and interest is payable semiannually through 2042. The bonds bear interest at 4% until December 2022, and 5% thereafter until maturity.

The loan agreement contains various restrictive covenants, including, but not limited to, a minimum required level of days cash on hand, a minimum required debt service ratio and restrictions on incurrence of additional debt.

- (C) At a rate of imputed interest at 1.25% due through 2021; collateralized by property and equipment. Property and equipment include the following property under capital leases:

	2017	2016
Equipment	\$ 268,042	\$ 268,042
Less accumulated depreciation	26,804	8,935
	\$ 241,238	\$ 259,107

Scheduled principal repayments on long-term debt and payments on capital lease obligations for the next five years and thereafter are as follows:

	Long-term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2018	\$ 720,000	\$ 59,388
2019	785,000	59,388
2020	815,000	59,388
2021	880,000	27,523
2022	940,000	-
Thereafter	32,380,000	-
	\$ 36,520,000	205,687
Less amount representing interest		4,805
Present value of future minimum lease payments		200,882
Less current maturities		57,113
Noncurrent portion		\$ 143,769

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Note 8: Medical Malpractice Claims

The Healthcare System is self-insured for the first \$200,000 per occurrence and \$600,000 in aggregate of medical malpractice risks. The Healthcare System is further covered by the Kansas Health Care Stabilization Fund for claims in excess of the self-insured professional liability plan limits up to \$800,000 pursuant to any one judgment or settlement against it for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy or plan year in the amount of \$2,400,000. The Healthcare System purchases commercial insurance coverage which provides for umbrella liability in excess of the underlying limits set forth above in the amount of \$20,000,000 per occurrence with an aggregate amount in any policy year of \$20,000,000. All coverage is on a claims made basis. Losses from asserted and unasserted claims identified under the Medical Center's incident reporting system are accrued based on estimates that incorporate the Medical Center's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. It is reasonably possible that the Medical Center's estimate of losses will change by a material amount in the near term.

The Healthcare System has established an agency account at a local bank to fund expected future malpractice losses and claims expenses. The agency account is funded based on the findings of an actuary. The balance of the agency accounts, which is included in assets limited as to use, was \$1,666,792 and \$1,668,370 at June 30, 2017 and 2016, respectively. The Healthcare System has included in accrued liabilities an accrual of \$400,000 and \$775,000 at June 30, 2017 and 2016, respectively, for the estimated present value of expected future malpractice losses and claims expenses.

Note 9: Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	2017	2016
As directed by the Foundation	\$ 30,612,758	\$ 27,600,320
For Hospice of Reno County services	69,066	160,666
	\$ 30,681,824	\$ 27,760,986

Permanently restricted net assets are restricted to:

	2017	2016
Investments to be held in perpetuity, the income is unrestricted	\$ 50,606	\$ -

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Note 10: Functional Expenses

The Healthcare System provides health care services primarily to residents within its geographic area. Expenses related to providing these services are as follows:

	2017	2016
Health care services	\$ 120,237,679	\$ 114,269,224
General and administrative	26,529,185	25,997,036
	\$ 146,766,864	\$ 140,266,260

Note 11: Pension Plan

The Hospital has a defined contribution pension plan covering substantially all full-time employees who have completed one year of service. Annual contributions to the plan are based on a percentage of eligible employee compensation. Pension expense was \$2,023,016 and \$2,335,697 for 2017 and 2016, respectively.

Note 12: Disclosures About Fair Value of Assets

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.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets; 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.
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets.

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Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2017 and 2016.

	June 30, 2017			
	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market accounts	\$ 474,147	\$ 474,147	\$ -	\$ -
Equity investments				
Common stock	181,749	181,749		
Mutual funds	12,366,714	12,366,714	-	-
International mutual funds	2,684,702	2,684,702	-	-
Fixed income investments				
Mortgage	143,180	143,180	-	-
Treasury	785,997	-	785,997	-
Asset-backed	402,254	-	402,254	-
Municipal bonds	155,697	-	155,697	-
International bonds	330,335	330,335	-	-
Tax exempt obligations	30,544	30,544	-	-
Bond mutual funds	3,822,074	3,822,074	-	-
Corporate bonds	1,422,687	1,422,687	-	-
Alternative investments (mutual funds)				
Hedge mutual funds	447,575	447,575	-	-
Infrastructure mutual funds	219,780	219,780	-	-
Traded real estate mutual funds	79,468	79,468	-	-
Total assets limited as to use for capital improvements	23,546,903	22,202,955	1,343,948	-
Money market accounts	1,312,331	1,312,331	-	-
Fixed income investments				
Treasury and agencies	4,660,138	-	4,660,138	-
Bond mutual funds	27,086	27,086	-	-
Total assets limited as to use for self-funded employee health, workers' compensation and professional liability insurance	5,999,555	1,339,417	4,660,138	-
Interest in net assets of Hutchinson Community Foundation	1,445,153	-	1,445,153	-

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	June 30, 2017			
	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market accounts	\$ 17,488,428	\$ 17,488,428	\$ -	\$ -
Equity investments				
Mutual funds	23,631,532	23,631,532	-	-
Common stock	3,801,441	3,801,441	-	-
International common stock	278,192	278,192	-	-
International mutual fund	7,641,584	7,641,584	-	-
Fixed income investments				
Mortgage	408,353	408,353	-	-
Treasury and agencies	9,570,863	-	9,570,863	-
Asset-backed	526,270	-	526,270	-
Municipal bonds	235,748	-	235,748	-
International bonds	123,166	123,166	-	-
Bond mutual funds	8,230,389	8,230,389	-	-
Tax exempt obligations	40,726	40,726	-	-
Corporate bonds	6,570,357	6,570,357	-	-
Government bonds	3,570,334	3,570,334	-	-
Alternative investments (mutual funds)				
Hedge mutual funds	1,162,202	1,162,202	-	-
Infrastructure mutual funds	563,558	563,558	-	-
Traded real estate mutual funds	202,773	202,773	-	-
Total long-term investments	84,045,916	73,713,035	10,332,881	-
Funds held on deposit with the Hutchinson Regional Medical Foundation	6,393,550	-	-	6,393,550
Total assets measured at fair value on a recurring basis	\$ 121,431,077	\$ 97,255,407	\$ 17,782,120	\$ 6,393,550

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	June 30, 2016			
	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market accounts	\$ 1,007,201	\$ 1,007,201	\$ -	\$ -
Equity investments				
Mutual funds	12,636,010	12,636,010	-	-
International funds	2,940,495	2,940,495	-	-
Fixed income investments				
Mortgage	206,278	206,278	-	-
Treasury	1,184,384	-	1,184,384	-
Asset-backed	357,512	-	357,512	-
Municipal bonds	189,950	-	189,950	-
Preferred stock	32,909	-	32,909	-
International bonds	40,180	40,180	-	-
Tax exempt obligations	31,234	31,234	-	-
Bond mutual funds	5,967,746	5,967,746	-	-
Corporate bonds	1,601,100	1,601,100	-	-
Alternative investments (mutual funds)				
Hedge mutual funds	656,768	656,768	-	-
Infrastructure mutual funds	157,199	157,199	-	-
Traded real estate mutual funds	110,102	110,102	-	-
Total assets limited as to use for capital improvements	27,119,068	25,354,313	1,764,755	-
Money market accounts	1,474,423	1,474,423	-	-
Fixed income investments				
Treasury and agencies	4,533,231	-	4,533,231	-
Bond mutual funds	27,591	27,591	-	-
Total assets limited as to use for self-funded employee health, workers' compensation and professional liability insurance	6,035,245	1,502,014	4,533,231	-
Interest in net assets of Hutchinson Community Foundation	1,262,075	-	1,262,075	-

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	June 30, 2016			
	Fair Value Measurements Using			
	Quoted Prices			
	in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Fair Value				
Money market accounts	\$ 2,075,847	\$ 2,075,847	\$ -	\$ -
Equity investments				
Mutual funds	20,275,442	20,275,442	-	-
Common stock	2,656,041	2,656,041	-	-
International common stock	299,866	299,866	-	-
International mutual fund	5,837,302	5,837,302	-	-
Fixed income investments				
Mortgage	383,376	383,376	-	-
Treasury and agencies	460,542	-	460,542	-
Asset-backed	586,529	-	586,529	-
Municipal bonds	282,216	-	282,216	-
Preferred stock	67,414	-	67,414	-
International bonds	279,752	279,752	-	-
Bond mutual funds	8,213,018	8,213,018	-	-
Tax exempt obligations	41,645	41,645	-	-
Corporate bonds	6,670,214	6,670,214	-	-
Government bonds	3,642,544	3,642,544	-	-
Alternative investments (mutual funds)				
Hedge mutual funds	1,345,735	1,345,735	-	-
Infrastructure mutual funds	313,496	313,496	-	-
Traded real estate mutual funds	222,616	222,616	-	-
Total long-term investments	<u>53,653,595</u>	<u>52,256,894</u>	<u>1,396,701</u>	<u>-</u>
Funds held on deposit with the Hutchinson Regional Medical Foundation	5,645,582	-	-	5,645,582
Total assets measured at fair value on a recurring basis	<u>\$ 93,715,565</u>	<u>\$ 79,113,221</u>	<u>\$ 8,956,762</u>	<u>\$ 5,645,582</u>

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended June 30, 2017.

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Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

Funds Held on Deposit with the Hutchinson Regional Medical Foundation

Horizons and HoRC's only investments at June 30, 2017 and 2016, are the funds held on deposit with the Foundation through an investment pool, which totaled \$6,393,550 and \$5,645,582, respectively. The Healthcare System cannot look through the investment pool to its underlying investments for fair value measurement purposes. Rather, the Healthcare System must consider if relevant observable inputs exist for interests in the investment pool. The funds held on deposit with the Foundation are classified as Level 3 under the fair value hierarchy because no observable inputs exist for interests in the investment pool. However, at June 30, 2017 and 2016, approximately 96% and 95%, respectively, of the underlying investments of the investment pool fall within Level 1 classification under the fair value hierarchy.

Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying consolidated balance sheets using significant unobservable (Level 3) inputs:

Balance, July 1, 2015	\$ 4,785,620
Interest and dividends	112,819
Net realized and unrealized losses	(108,063)
Investment fees	(14,423)
Purchases	<u>869,629</u>
Balance, June 30, 2016	<u>5,645,582</u>
Interest and dividends	151,416
Net realized and unrealized gains	512,461
Investment fees	(1,008)
Purchases	<u>85,099</u>
Balance, June 30, 2017	<u><u>\$ 6,393,550</u></u>

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

Note 13: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in *Notes 1* and *2*.

Medical Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in *Notes 1* and *8*.

Litigation

In the normal course of business, the Healthcare System 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 Medical Center's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Healthcare System evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Guarantees

HASC has a \$500,000 line of credit with a local bank. The Medical Center has guaranteed \$100,000 of this line of credit and is contingently liable under the guarantee should HASC fail to make payments on the line of credit as they become due. HHCSI has an available line of credit with a local bank for \$200,000. There were no borrowings outstanding against either line of credit at June 30, 2017.

Investments

The Healthcare System invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying consolidated balance sheets.

Hutchinson Regional Medical Center, Inc.
Notes to Consolidated Financial Statements
June 30, 2017 and 2016

Note 14: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the consolidated financial statements, which is the date the consolidated financial statements were issued.

Supplementary Information

Hutchinson Regional Medical Center, Inc.
Consolidating Schedule – Balance Sheet
June 30, 2017

Assets

	Hutchinson Regional Medical Center, Inc.	Horizons Mental Health Center, Inc.	Hutchinson Health Care Services, Inc.	Hospice of Reno County, Inc.	The Living Center, Inc.	Main Line, Inc.	Eliminations and Reclassi- fications	Total
Current Assets								
Cash and cash equivalents	\$ 23,450,878	\$ 3,678,909	\$ 1,757,883	\$ 305,721	\$ 252,696	\$ 3,633,559	\$ -	\$ 33,079,646
Assets limited as to use, current	1,963,282	-	-	-	-	-	-	1,963,282
Funds held on deposit with the Hutchinson Regional Medical Foundation	-	6,110,848	-	282,702	-	-	-	6,393,550
Patient accounts receivable, net	31,676,322	1,098,587	188,882	1,058,832	8,391	-	-	34,031,014
Other receivables	1,206,203	27,608	141,088	3,700	908	277,078	(459,918)	1,196,667
Net investment in direct financing leases	-	-	-	-	-	1,203,475	-	1,203,475
Supplies	4,709,349	-	382,082	-	-	-	-	5,091,431
Prepaid expenses and other	2,828,094	123,662	108,683	63,185	-	17,705	(170,494)	2,970,835
Total current assets	65,834,128	11,039,614	2,578,618	1,714,140	261,995	5,131,817	(630,412)	85,929,900
Assets Limited As To Use								
Internally designated								
For capital improvements	23,565,115	-	-	-	-	-	-	23,565,115
For self-funded employee health, workers' compensation and professional liability insurance	5,999,555	-	-	-	-	-	-	5,999,555
Interests in net assets of foundations	30,612,758	-	-	1,445,153	-	-	-	32,057,911
	60,177,428	-	-	1,445,153	-	-	-	61,622,581
Less amount required to meet current obligations	1,963,282	-	-	-	-	-	-	1,963,282
	58,214,146	-	-	1,445,153	-	-	-	59,659,299
Property and Equipment, Net	58,109,484	241,356	663,235	767,266	-	4,423,697	-	64,205,038
Other Assets								
Net investment in direct financing leases	-	-	-	-	-	17,288,695	-	17,288,695
Investments in subsidiary	480,000	-	-	-	-	-	(480,000)	-
Long-term investments	83,709,826	-	1,121,819	-	-	-	-	84,831,645
Other	-	-	-	-	-	24,465	-	24,465
	84,189,826	-	1,121,819	-	-	17,313,160	(480,000)	102,144,805
Total assets	\$ 266,347,584	\$ 11,280,970	\$ 4,363,672	\$ 3,926,559	\$ 261,995	\$ 26,868,674	\$ (1,110,412)	\$ 311,939,042

Hutchinson Regional Medical Center, Inc.
Consolidating Schedule – Balance Sheet (Continued)
June 30, 2017

Liabilities and Net Assets

	Hutchinson Regional Medical Center, Inc.	Horizons Mental Health Center, Inc.	Hutchinson Health Care Services, Inc.	Hospice of Reno County, Inc.	The Living Center, Inc.	Main Line, Inc.	Eliminations and Reclassi- fications	Total
Current Liabilities								
Current maturities of long-term debt	\$ 720,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 720,000
Current maturities of capital lease obligations	57,113	-	-	-	-	-	-	57,113
Accounts payable	6,793,251	230,793	119,966	326,655	261,995	73,810	(459,918)	7,346,552
Accrued expenses	7,309,531	1,190,796	256,188	426,752	-	-	(170,494)	9,012,773
Deferred revenue	2,971	-	-	-	-	-	-	2,971
Estimated amounts due to third-party payers	818,437	-	-	-	-	-	-	818,437
Total current liabilities	15,701,303	1,421,589	376,154	753,407	261,995	73,810	(630,412)	17,957,846
Long-term Debt	36,290,227	-	-	-	-	-	-	36,290,227
Capital Lease Obligations	143,769	-	-	-	-	-	-	143,769
Total liabilities	52,135,299	1,421,589	376,154	753,407	261,995	73,810	(630,412)	54,391,842
Net Assets								
Unrestricted	183,599,527	9,859,381	3,987,518	3,053,480	-	26,794,864	(480,000)	226,814,770
Temporarily restricted	30,612,758	-	-	69,066	-	-	-	30,681,824
Permanently restricted	-	-	-	50,606	-	-	-	50,606
Total net assets	214,212,285	9,859,381	3,987,518	3,173,152	-	26,794,864	(480,000)	257,547,200
Total liabilities and net assets	\$ 266,347,584	\$ 11,280,970	\$ 4,363,672	\$ 3,926,559	\$ 261,995	\$ 26,868,674	\$ (1,110,412)	\$ 311,939,042

Hutchinson Regional Medical Center, Inc.
Consolidating Schedule – Statement of Operations
Year Ended June 30, 2017

	Hutchinson Regional Medical Center, Inc.	Horizons Mental Health Center, Inc.	Hutchinson Health Care Services, Inc.	Hospice of Reno County, Inc.	The Living Center, Inc.	Main Line, Inc.	Eliminations and Reclassi- fications	Total
Unrestricted Revenues, Gains and Other Support								
Net patient service revenue	\$ 142,438,122	\$ 8,590,870	\$ 3,606,297	\$ 6,222,315	\$ 156,539	\$ -	\$ -	\$ 161,014,143
Provision for uncollectible accounts	17,117,513	774,042	14,833	22,661	61,895	-	-	17,990,944
Net patient service revenue less provision for uncollectible accounts	125,320,609	7,816,828	3,591,464	6,199,654	94,644	-	-	143,023,199
Electronic health records incentive	13,385	-	-	-	-	-	-	13,385
Other	2,220,209	2,650,410	138,907	-	3,683	1,933,105	(297,184)	6,649,130
Net assets released from restrictions used for operations	132,169	-	-	51,255	-	-	-	183,424
Total unrestricted revenues, gains and other support	<u>127,686,372</u>	<u>10,467,238</u>	<u>3,730,371</u>	<u>6,250,909</u>	<u>98,327</u>	<u>1,933,105</u>	<u>(297,184)</u>	<u>149,869,138</u>
Expenses and Losses								
Salaries and wages	42,790,797	7,691,142	1,369,721	3,551,529	720,202	35,021	-	56,158,412
Employee benefits	10,999,541	1,997,596	388,769	948,673	165,623	-	-	14,500,202
Purchased services, supplies and other	61,695,255	1,964,784	1,416,336	1,983,497	309,938	504,018	(297,184)	67,576,644
Depreciation	7,076,139	95,878	235,496	114,673	199,000	547,191	-	8,268,377
Income tax expense	-	-	120,518	-	-	-	-	120,518
Interest	142,711	-	-	-	-	-	-	142,711
Total expenses and losses	<u>122,704,443</u>	<u>11,749,400</u>	<u>3,530,840</u>	<u>6,598,372</u>	<u>1,394,763</u>	<u>1,086,230</u>	<u>(297,184)</u>	<u>146,766,864</u>
Operating Income (Loss)	<u>4,981,929</u>	<u>(1,282,162)</u>	<u>199,531</u>	<u>(347,463)</u>	<u>(1,296,436)</u>	<u>846,875</u>	<u>-</u>	<u>3,102,274</u>
Other Income (Expense)								
Investment return	8,170,992	649,315	91,837	-	439	-	-	8,912,583
Contributions received	-	-	-	295,662	-	-	-	295,662
Insurance recoveries	99,381	-	-	-	-	10,236	-	109,617
Other	(369,304)	-	21,106	149,889	390,785	-	-	192,476
Total other income (expense)	<u>7,901,069</u>	<u>649,315</u>	<u>112,943</u>	<u>445,551</u>	<u>391,224</u>	<u>10,236</u>	<u>-</u>	<u>9,510,338</u>
Excess (Deficiency) of Revenues Over Expenses	<u>12,882,998</u>	<u>(632,847)</u>	<u>312,474</u>	<u>98,088</u>	<u>(905,212)</u>	<u>857,111</u>	<u>-</u>	<u>12,612,612</u>
Investment return - change in unrealized gains (losses) on other than trading securities	(22,673)	-	-	-	-	-	-	(22,673)
Net assets released from restriction used for purchase of property and equipment	35,574	-	-	-	-	-	-	35,574
Transfers between affiliates	1,964,155	-	-	-	35,845	(2,000,000)	-	-
Increase (Decrease) in Unrestricted Net Assets	<u>\$ 14,860,054</u>	<u>\$ (632,847)</u>	<u>\$ 312,474</u>	<u>\$ 98,088</u>	<u>\$ (869,367)</u>	<u>\$ (1,142,889)</u>	<u>\$ -</u>	<u>\$ 12,625,513</u>

Hutchinson Regional Medical Center, Inc.
Consolidating Schedule – Statement of Changes in Net Assets
Year Ended June 30, 2017

	Hutchinson Regional Medical Center, Inc.	Horizons Mental Health Center, Inc.	Hutchinson Health Care Services, Inc.	Hospice of Reno County, Inc.	The Living Center, Inc.	Main Line, Inc.	Eliminations and Reclassi- fications	Total
Unrestricted Net Assets								
Excess (deficiency) of revenues over expenses	\$ 12,882,998	\$ (632,847)	\$ 312,474	\$ 98,088	\$ (905,212)	\$ 857,111	\$ -	\$ 12,612,612
Investment return - change in unrealized losses on other than trading securities	(22,673)	-	-	-	-	-	-	(22,673)
Net assets released from restriction used for purchase of property and equipment	35,574	-	-	-	-	-	-	35,574
Transfers between affiliates	1,964,155	-	-	-	35,845	(2,000,000)	-	-
	<u>14,860,054</u>	<u>(632,847)</u>	<u>312,474</u>	<u>98,088</u>	<u>(869,367)</u>	<u>(1,142,889)</u>	<u>-</u>	<u>12,625,513</u>
Increase (decrease) in unrestricted net assets								
Temporarily Restricted Net Assets								
Contributions received	167,743	-	-	-	-	-	-	167,743
Change in interests in net assets of foundations	3,012,438	-	-	-	-	-	-	3,012,438
Net assets released from restriction used for operations	(132,169)	-	-	(51,255)	-	-	-	(183,424)
Net assets released from restriction used for purchase of property and equipment	(35,574)	-	-	-	-	-	-	(35,574)
Reclassification of net assets	-	-	-	(40,345)	-	-	-	(40,345)
	<u>3,012,438</u>	<u>-</u>	<u>-</u>	<u>(91,600)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,920,838</u>
Increase (decrease) in temporarily restricted net assets								
Permanently Restricted Net Assets								
Contributions received	-	-	-	10,261	-	-	-	10,261
Reclassification of net assets	-	-	-	40,345	-	-	-	40,345
	<u>-</u>	<u>-</u>	<u>-</u>	<u>50,606</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>50,606</u>
Increase in permanently restricted net assets								
Changes in Net Assets	17,872,492	(632,847)	312,474	57,094	(869,367)	(1,142,889)	-	15,596,957
Net Assets, Beginning of Year	196,339,793	10,492,228	3,675,044	3,116,058	869,367	27,937,753	(480,000)	241,950,243
Net Assets, End of Year	<u>\$ 214,212,285</u>	<u>\$ 9,859,381</u>	<u>\$ 3,987,518</u>	<u>\$ 3,173,152</u>	<u>\$ -</u>	<u>\$ 26,794,864</u>	<u>\$ (480,000)</u>	<u>\$ 257,547,200</u>