

**STATE BOARD OF ACCOUNTS**  
**302 West Washington Street**  
**Room E418**  
**INDIANAPOLIS, INDIANA 46204-2769**

AUDIT REPORT  
OF

SCOTT MEMORIAL HOSPITAL  
A COMPONENT UNIT OF  
SCOTT COUNTY, INDIANA

January 1, 2012 to December 31, 2012



**FILED**  
09/10/2013



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HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Executive Director	Clifford D. Nay Angela G. Doan (Interim)	01-01-12 to 10-26-12 10-27-12 to 12-31-12
Treasurer	Angela G. Doan	01-01-12 to 12-31-12
Chairman of the Hospital Board	Donna Faris	01-01-12 to 12-31-12
President of the Board of County Commissioners	Mark Hays Robert C. Tobias	01-01-12 to 12-31-12 01-01-13 to 12-31-13
President of the County Council	Kelley Robbins Eric Gillespie	01-01-12 to 12-31-12 01-01-13 to 12-31-13



**STATE OF INDIANA**  
AN EQUAL OPPORTUNITY EMPLOYER

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INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF THE SCOTT MEMORIAL HOSPITAL, SCOTT COUNTY, INDIANA

**Report on the Financial Statements**

We have audited the accompanying financial statements of the Scott Memorial Hospital (Hospital), as of and for the year ended December 31, 2012, 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 opinions on these financial statements based on our audit. We conducted our audit 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 financial statements are free of 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 Hospital's internal control. Accordingly, we express no such opinion. An audit 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 statement.

We believe that our 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 respective financial position of the Hospital as of December 31, 2012, and the respective changes in financial position and cash flows, where applicable, thereof and for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT  
(Continued)

***Emphasis of a Matter***

The accompanying financial statements were prepared for the final year the Hospital operated as a component unit of Scott County. As described in Note III-C, Scott County completed a purchase agreement with the Regional Healthcare Network of Kentucky and Southern Indiana selling the Hospital effective December 31, 2012. Our opinion is not modified with respect to this matter.

***Other Matters***

*Required Supplementary Information*

Management has omitted Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.



Bruce Hartman  
State Examiner

July 17, 2013

SCOTT MEMORIAL HOSPITAL  
STATEMENT OF NET POSITION  
December 31, 2012  
(In Thousands)

<b>ASSETS</b>	
Cash and cash equivalents	\$ 2,287
Receivables (net of allowance for uncollectibles)	3,989
Other	684
Inventories	447
Prepaid expenses	101
Capital assets not being depreciated:	
Land	241
Capital assets net of accumulated depreciation:	
Buildings	14,228
Improvements other than buildings	43
Fixed equipment	420
Major movable equipment	<u>4,515</u>
 Total assets	 <u>26,955</u>
<b>LIABILITIES</b>	
Accounts payable	643
Accrued liabilities	598
Estimated third-party payor settlements	<u>1,585</u>
 Total liabilities	 <u>2,826</u>
<b>NET POSITION</b>	
Net investment in capital assets	19,447
Unrestricted	<u>4,682</u>
 Total net position	 <u>\$ 24,129</u>

The accompanying notes are an integral part of the financial statements.

SCOTT MEMORIAL HOSPITAL  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION  
Year Ended December 31, 2012  
(In Thousands )

Net patient service revenues (net of provision for bad debt)	\$	19,840
Other operating revenues		<u>628</u>
 Total operating revenues		 <u>20,468</u>
Operating expenses:		
Personnel		11,621
Supplies		2,099
Purchased services		4,829
Professional fees		707
Other		1,130
Depreciation		<u>2,461</u>
 Total operating expenses		 <u>22,847</u>
Loss from operations		<u>(2,379)</u>
Nonoperating revenue:		
Investment income		<u>3</u>
Contributions		<u>60</u>
Change in net position		<u>(2,316)</u>
Net position - beginning		<u>26,445</u>
Net position - ending	\$	<u><u>24,129</u></u>

The accompanying notes are an integral part of the financial statements.

SCOTT MEMORIAL HOSPITAL  
STATEMENT OF CASH FLOWS  
Year Ended December 31, 2012  
(In Thousands)

**CASH FLOWS FROM OPERATING ACTIVITIES**

**Cash flows from operating activities:**

Receipts from and on behalf of patients	\$ 20,106
Payments to suppliers and contractors	(9,762)
Payments to employees	(11,422)
Other receipts and payments, net	<u>1,749</u>

Net cash provided by operating activities	<u>671</u>
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**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

Noncapital contributions	<u>60</u>
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**CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES**

Purchase of capital assets	<u>(781)</u>
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**CASH FLOWS FROM INVESTING ACTIVITIES**

Investment income	<u>3</u>
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Net increase in cash and cash equivalents	<u>(47)</u>
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Cash and cash equivalents at beginning of year	<u>2,334</u>
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Cash and cash equivalents at end of year	<u>\$ 2,287</u>
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**Reconciliation of operating loss to net cash provided by operating activities:**

Operating loss	<u>\$ (2,379)</u>
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Adjustments to reconcile operating income to net cash flows used in operating activities:

Depreciation	2,461
Decrease in patient accounts receivable	265
Increase in supplies and other current assets	(348)
Decrease in accounts payable	(307)
Decrease in accrued expenses	(142)
Increase in estimated third-party payor settlements	<u>1,121</u>

Total adjustments	<u>3,050</u>
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Net cash provided in operating activities	<u>\$ 671</u>
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The accompanying notes are an integral part of the financial statements.

SCOTT MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

Scott Memorial Hospital (Hospital) is a county-owned facility and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital provides short-term inpatient and outpatient health care.

The Board of County Commissioners of Scott County appoints the Governing Board of the Hospital and a financial benefit/burden relationship exists between the County and the Hospital. For these reasons, the Hospital is considered a component unit of Scott County. (See Note III-C. Sale of Hospital)

The accompanying financial statements present the activities of the Hospital (primary government) and its significant component units. The component unit discussed below is included in the Hospital's reporting entity because of the significance of its operational or financial relationship with the Hospital. Blended component units, although legally separate entities, are in substance part of the government's operations and exist solely to provide services for the government; data from these units is combined with data of the primary government.

Blended Component Unit

Scott Physicians Group (SPG) is a significant blended component unit of the Hospital. The primary government appoints a voting majority of the SPG's board and is able to impose its will. Although it is legally separate from the Hospital, SPG is reported as if it were a part of the Hospital because SPG benefits the Hospital exclusively by providing services indirectly.

B. Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

C. Assets, Liabilities, and Net Assets or Equity

1. Deposits and Investments

Cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less.

Short-term investments are investments with remaining maturities of up to 90 days.

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

Nonparticipating certificates of deposit, demand deposits, and similar nonparticipating negotiable instruments that are not reported as cash and cash equivalents are reported as investments at cost.

SCOTT MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

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

Open-end mutual funds are reported at fair value.

Money market investments that mature within one year or less at the date of their acquisition are reported at amortized cost. Other money market investments are reported at fair value.

Investments in affiliated companies are reported using the equity method of accounting, or at cost, as applicable.

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating revenues in the statement of revenues, expenses, and changes in net position.

2. 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 and liabilities and disclosures 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.

3. Capital Assets

Capital assets, which include land, land improvements, buildings and improvements, and equipment, are reported at actual or estimated historical cost based on appraisals or deflated current replacement cost. Contributed or donated assets are reported at estimated fair value at the time received.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods and estimated useful lives of capital assets reported in the financial statements are as follows:

	Capitalization Threshold	Depreciation Method	Estimated Useful Life
Buildings	\$ 1,000	Straight-line	3 to 50 years
Improvements other than buildings	1,000	Straight-line	5 to 25 years
Fixed equipment	1,000	Straight-line	5 to 25 years
Major movable equipment	1,000	Straight-line	5 to 12 years

For depreciated assets, the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

SCOTT MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

4. Net Position

Net position of the Hospital is classified in two components.

Net investment in capital assets is capital assets net of accumulated depreciation.

Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets.

D. Grants and Contributions

From time to time, the Hospital receives grants from Scott County and the State of Indiana as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

E. Restricted Resources

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

F. Operating Revenues and Expenses

The Hospital's statement of revenues, expenses and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Hospital's principal activity. Nonexchange revenues, including grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

G. Net Patient Service Revenue

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

H. Charity Care

The Hospital has a policy of providing charity care to patients who are unable to pay. Such patients are identified based on financial information obtained from the patient and subsequent analysis. Because the agency does not expect payment, estimated charges for charity are not included in revenue.

SCOTT MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

I. Supplies

Inventories of drugs and other supplies are stated at the lower of cost (first-in, first-out) or market.

J. Fair Value of Financial Instruments

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

Cash and Cash Equivalents

The carrying amount reported in the statement of net position for cash and cash equivalents approximates its fair value.

Investments

Fair values, which are the amounts reported in the statement of net position, are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Accounts Payable and Accrued Expenses

The carrying amount reported in the statement of net position for accounts payable and accrued expenses approximates its fair value.

Estimated Third-Party Payor Settlements

The carrying amount reported in the statement of net position for estimated third-party payor settlements approximates its fair value.

II. Detailed Notes

A. Deposits and Investments

1. Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 16-22-3-16 allows a Hospital Governing Board to deposit public funds in a financial institution. The Hospital does not have a deposit policy for custodial credit risk. At December 31, 2012, the Hospital had deposit balances in the amount of \$2,287,000.

The bank balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

2. Investments

Statutory Authorization for Investments

Indiana Code 16-22-3-20 authorizes the Hospital to invest in:

SCOTT MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

Any interest bearing account that is authorized to be set up and offered by a financial institution or brokerage firm registered and authorized to do business in Indiana.

Repurchase or resale agreements involving the purchase and guaranteed resale of any interest bearing obligations issued or fully insured or guaranteed by the United States or any United States government agency in which type of agreement the amount of money must be fully collateralized by interest bearing obligations as determined by the current market value computed on the day the agreement is effective.

Mutual funds offered by a financial institution or brokerage firm registered and authorized to do business in Indiana.

Securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

Pooled fund investments for participating hospitals offered, managed, and administered by a financial institution or brokerage firm registered or authorized to do business in Indiana.

B. Accounts Receivable and Payable

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at year end consisted of these amounts:

Patient Accounts Receivable	(In Thousands)
Receivable from patients and their insurance carriers	\$ 6,941
Receivable from Medicare	763
Receivable from Medicaid	391
Scott Physicians' Group*	270
Total patient accounts receivable	\$ 8,365
Less allowance for uncollectible amounts	4,376
Patient accounts receivable, net	\$ 3,989

\* Source of receivable information not available.

Accounts Payable and Accrued Expenses

Payable to employees (including payroll taxes)	\$ 598
Payable to suppliers	643
Total accounts payable and accrued expenses	\$ 1,241

SCOTT MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

C. Capital Assets

Capital asset activity for the year ended December 31, 2012, was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 241	\$ -	\$ -	\$ 241
Construction in progress	41	865	906	-
Total capital assets, not being depreciated	<u>282</u>	<u>865</u>	<u>906</u>	<u>241</u>
Capital assets, being depreciated:				
Buildings	22,808	69	-	22,877
Improvements other than buildings	521	-	-	521
Fixed equipment	2,410	37	-	2,447
Major movable equipment	<u>14,768</u>	<u>670</u>	<u>565</u>	<u>14,873</u>
Total assets being depreciated	<u>40,507</u>	<u>776</u>	<u>565</u>	<u>40,718</u>
Less accumulated depreciation for:				
Buildings	(7,708)	(941)	-	(8,649)
Improvements other than buildings	(457)	(21)	-	(478)
Fixed equipment	(1,943)	(84)	-	(2,027)
Major movable equipment	<u>(9,521)</u>	<u>(1,415)</u>	<u>578</u>	<u>(10,358)</u>
Totals	<u>(19,629)</u>	<u>(2,461)</u>	<u>578</u>	<u>(21,512)</u>
Total capital assets, being depreciated, net	<u>20,878</u>	<u>(1,685)</u>	<u>1,143</u>	<u>19,206</u>
Total primary government capital assets, net	<u>\$ 21,160</u>	<u>\$ (820)</u>	<u>\$ 2,049</u>	<u>\$ 19,447</u>

D. Operating Lease

On September 15, 2008, the Hospital signed a five year operating lease agreement with the Veterans Administration (VA). The VA leased a building from the Hospital. Under terms of the agreement, the annual lease cost is recomputed each federal fiscal year. Payments are monthly. The agreed-upon annual lease cost for the federal fiscal year ending September 30, 2012 was \$253,467.

E. Net Patient Service Revenue

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

1. Medicare

Inpatient acute care services and 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

SCOTT MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

non-acute services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

2. Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary.

Revenue from the Medicare and Medicaid programs accounted for approximately 40 percent and 19 percent, respectively, of the Hospital's net patient revenue for the year ended 2012 and 39 percent and 22 percent, respectively, of the Hospital's net patient revenue for the year ended 2011. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Hospital also has entered into payment agreements with certain commercial insurance carriers, HMO's, 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.

F. Disproportionate Share Hospital Payments

Disproportionate Share Hospital (DSH) adjustment payments provide additional funds to hospitals that serve a significantly disproportionate number of low-income patients. States receive an annual DSH allotment from the federal government to cover the costs of qualifying hospitals that provide care to low-income patients not covered by other payers. The Hospital qualified as a DSH and received \$562,423 in 2012. The revenue from the program is included in net patient service revenue.

III. Other Information

A. Risk Management

The Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; and natural disasters.

The risks of torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; and natural disasters are covered by commercial insurance from independent third parties.

SCOTT MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

B. Contingent Liabilities

Litigation

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

C. Sale of Hospital

In May, of the year 2012, the Hospital signed a letter of intent with the Regional Health Network of Kentucky and Southern Indiana a newly formed joint venture between Norton Healthcare and Lifepoint Hospital (Buyer) to sell the Hospital's assets. The Scott County Board of Commissioners and the Scott County Council approved the proposal.

The initial estimated sales price was \$10,332,524. It was computed on a base cash purchase price of \$6,300,000 plus \$4,032,524 the value of net working capital excluding cash as of September 30, 2012. On December 31, 2012, \$7,312,803 was paid to Scott County and \$3,019,721 was placed in an escrow account. On that date the Hospital's assets were conveyed to the Buyer.

A final determination of the sales price is to be made by July 19, 2013. The actual net working capital-excluding cash as of December 31, 2012, will be used to determine the final sales price. At that time, funds held in the escrow account will be released to the County and/or Buyer. If funds in the escrow account are insufficient to cover the distribution to one party, the other is obligated to make up the difference from its funds.

SCOTT MEMORIAL HOSPITAL  
EXIT CONFERENCE

The contents of this report were discussed on July 17, 2013, with Angela G. Doan, Treasurer through December 31, 2012; Eric Gillespie, President of the County Council; and Robert C. Tobias, President of the Board of County Commissioners. Our audit disclosed no material items that warrant comment at this time.