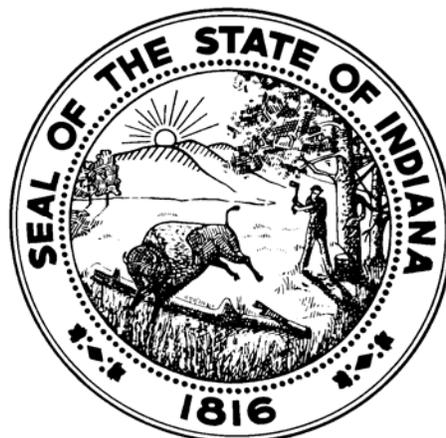


STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

AUDIT REPORT
OF

DAVISS COMMUNITY HOSPITAL
A COMPONENT UNIT OF
DAVISS COUNTY, INDIANA

January 1, 2006 to December 31, 2006



FILED

05/29/2007

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HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Executive Director	James Heckert	01-01-06 to 12-31-07
Chief Financial Officer	Brad Hardcastle	01-01-06 to 12-31-07
Chairman of the Hospital Board	Eric Moll	01-01-06 to 12-31-07
President of the Board of County Commissioners	Tony Wichman Steve Myers	01-01-06 to 12-31-06 01-01-07 to 12-31-07



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INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF THE DAVIESS COMMUNITY HOSPITAL, DAVIESS COUNTY, INDIANA

We have audited the accompanying basic financial statements of Daviess Community Hospital (Hospital), as of and for the year ended December 31, 2006, as listed in the table of contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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, 2006, and the respective changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States.

The Management's Discussion and Analysis, as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

STATE BOARD OF ACCOUNTS

April 25, 2007



Management's Discussion and Analysis

Our discussion and analysis of Daviness Community Hospital's (the Hospital) financial performance provides an overview of the Hospital's financial statements for the fiscal year ended December 31, 2006. Please read it in conjunction with the Hospital's financial statements and accompanying notes to the financial statements. Unless otherwise stated, amounts are presented in millions.

Using This Annual Report

This annual report consists of the *Management's Discussion and Analysis*, and the *Basic Financial Statements*.

- In the *Management's Discussion and Analysis* section of this report, the Hospital discusses various components of the annual report and provides an analysis of the current financial statement information.
- The *Basic Financial Statement* section of this report includes a series of financial statements which provide information about the activities of the Hospital as a whole. The Statement of Net Assets reveals the assets and liabilities of the Hospital on December 31, 2006 while the Statement of Revenues, Expenses and Changes in Net Assets summarizes the change in cash and cash equivalents as a result of the financial activity during the year. The Notes to the Financial Statements disclose additional information addressed within the body of the financial statements.

Financial Highlights

- The Hospital's net assets increased by \$1.7 million or 5% as a result of this year's operations.
- The Hospital's net operating revenues of \$47.3 million increased by \$4.0 million or 9% from prior year.
- The Hospital's operating expenses of \$46.4 million increased by \$3.6 million or 8% from the prior year. This increase was primarily related to the \$2.7 million or 13% increase in salary and benefit expense, and a \$0.5 million increase in depreciation and amortization.

Summarized Financial Statement Information

The following financial reports *Net Assets* and *Changes in Net Assets* document in summary form the financial information related to the activities of the Hospital for Calendar Year 2006 and Prior Year 2005. Related notes follow the financial reports.

NET ASSETS		
	2006	2005
Current Assets	\$16.8	\$13.1
Noncurrent Assets	10.5	11.0
Capital Assets	34.1	34.0
Total Assets	61.4	58.1
Current Liabilities	4.4	4.3
Long-Term Debt	21.9	20.4
Total Liabilities	26.3	24.7
Net Assets		
Invested in Capital Assets	10.8	12.4
Restricted	2.4	2.9
Unrestricted	21.9	18.1
Total Net Assets	\$35.1	\$33.4

Current Assets of \$16.8 million increased \$3.7 million or 28% from the prior year.

Long-Term Debt of \$21.9 million increased \$1.5 million or 7% from the prior year. The hospital refunded its 1998 and 1999 bond issues with a new 2006 revenue bond and borrowed an additional \$1.5 million. A 5-year capital lease was entered into for the purchase of a PACS system.

CHANGES IN NET ASSETS		
	2006	2005
Revenue		
Net Patient Service Revenue	\$46.5	\$42.4
Other Revenues	0.8	0.9
Total Revenues	47.3	43.3
Expenses		
Salaries and Benefits	23.7	21.1
Medical Supplies and Drugs	4.4	4.8
Insurance	0.6	0.4
Other Supplies	1.2	1.2
Depreciation and Amortization	3.2	2.7
Other Expenses	13.3	12.6
Total Expenses	46.4	42.8
Operating Income (Loss)	0.9	0.5
Nonoperating Revenues (Expenses)	0.8	1.0
Increase (Decrease) In Net Assets	1.7	1.5
Net Assets Beginning of the Year	33.4	31.9
Net Assets End of the Year	\$35.1	\$33.4

The Hospital reported a \$1.7 million increase in net assets for Calendar Year 2006. Net assets is the difference between net patient service revenues and the expenses incurred to perform those services.

The primary components for net assets in 2006 are:

- The Hospital's net operating revenues of \$47.3 million increased by \$4.0 million or 9% from prior year. Inpatient service revenue increased 4%, outpatient revenue increased 15%, and physician clinic revenue increased 20%. Revenue deductions increased from 41.3% in 2005 to 42.0% in 2006.
- The Hospital's operating expenses of \$46.4 million increased by \$3.6 million or 8% from prior year. Salaries and related benefits increased \$2.7 million or 13%. Physician salaries were up \$0.4 million, there were market and merit increases of \$0.6 million, and a total of 23 additional paid FTE's compared to 2005. Health insurance and worker's compensation expense increased \$0.4 million.
- Bad debt expense increased \$0.7 million or 29%. This increase is related to the growing uninsured and underinsured population.

Capital Assets and Debt Administration

Capital Assets

At the end of 2006, the Hospital had \$34.1 million invested in capital assets. The Hospital had a net increase of \$0.1 million over prior year. The table displayed below documents the type of assets that makeup the capital assets held by the hospital as of December 31, 2006.

Capital Assets at Year-End Net of Depreciation		
	2006	2005
Land	\$1.2	\$0.7
Land Improvements/Leasehold Improvements	0.7	0.6
Building	35.6	35.5
Equipment	20.5	18.8
Total	58.0	55.6
Less Accumulated Depreciation	24.2	21.6
Subtotal	33.8	34.0
Construction In Progress	0.3	0.0
Capital Assets (Net)	\$34.1	\$34.0

Debt

At year-end, the Hospital had approximately \$24.1 million in long-term debt (financial statements are shown net of bond discount). The table below documents the debt held.

Outstanding Debt at Year End		
	2006	2005
Variable Rate Hospital Revenue Bonds		
2001 Revenue Bonds	\$3.8	\$4.5
Indiana Health Facility Financing Authority (IHFFA)		
1998/1999 Revenue Bonds	0.0	17.3
2006 Revenue Bond (Refunded 1998 and 1999 series)	19.2	0.0
PACS Capital Lease	1.1	0.0
Total Debt	\$24.1	\$21.8

Economic Factors

As discussed in the **Changes of Net Asset** section, bad debt continues to increase as a result of a growing uninsured population and higher coinsurance and deductibles faced by insured patients.

Contacting the Hospital's Management

This financial report is designed to provide our citizens, taxpayers, patients, and other interested parties with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it received. If you have questions about this report or need additional financial information, please contact Daviess Community Hospital, Department of Finance, 1314 East Walnut Street, PO Box 760, Washington, IN 47501.

DAVISS COMMUNITY HOSPITAL
STATEMENT OF NET ASSETS
December 31, 2006

Assets

Current assets:	
Cash and cash equivalents	\$ 3,773,819
Patient accounts receivable, net of estimated uncollectibles of \$5,042,355	7,861,647
Estimated third-party settlements	232,105
Supplies and other current assets	3,955,522
Noncurrent cash and investments:	
Internally designated	8,129,063
Held by trustee for debt service	2,393,753
Restricted by contributors and grantors	1,990
Capital assets:	
Land	1,436,477
Depreciable capital assets, net of accumulated depreciation	32,638,597
Other assets	<u>970,045</u>
 Total assets	 <u>\$ 61,393,018</u>

Liabilities and Net Assets

Current liabilities:	
Current maturities of long-term debt	\$ 1,367,584
Accounts payable and accrued expenses	1,961,032
Other current liabilities	1,043,137
Long-term debt, net of current maturities	<u>21,936,575</u>
 Total liabilities	 <u>26,308,328</u>
Net assets:	
Invested in capital assets, net of related debt	10,770,914
Restricted:	
For debt service	2,393,753
Nonexpendable permanent endowments	1,990
Unrestricted	<u>21,918,033</u>
 Total net assets	 <u>35,084,690</u>
 Total liabilities and net assets	 <u>\$ 61,393,018</u>

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

DAVIESS COMMUNITY HOSPITAL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year Ended December 31, 2006

Operating revenues:	
Net patient service revenue (net of provision for bad debt)	\$ 46,516,611
Other	<u>743,109</u>
Total operating revenues	<u>47,259,720</u>
Operating expenses:	
Salaries and benefits	23,854,608
Medical supplies and drugs	4,381,223
Insurance	553,365
Other supplies	1,222,443
Other expenses	13,255,431
Depreciation and amortization	<u>3,155,477</u>
Total operating expenses	<u>46,422,547</u>
Operating income	<u>837,173</u>
Nonoperating revenues:	
Investment income	539,181
Gain on sale of equipment	47,066
Other	<u>247,258</u>
Total nonoperating revenues	<u>833,505</u>
Increase in net assets	1,670,678
Net assets beginning of the year	<u>33,414,012</u>
Net assets end of the year	<u>\$ 35,084,690</u>

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

DAVISS COMMUNITY HOSPITAL
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS
Year Ended December 31, 2006

	2006
Cash flows from operating activities:	
Receipts from and on behalf of patients	\$ 46,671,747
Payments to suppliers and contractors	(6,455,755)
Payments to employees	(23,854,608)
Other receipts and payments, net	<u>(11,611,314)</u>
Net cash provided by operating activities	<u>4,750,070</u>
Cash flows from capital and related financing activities:	
Proceeds from sale of revenue bonds	1,462,354
Principal paid on long-term debt	(1,181,560)
Interest paid on long-term debt	(1,227,493)
Purchase of capital assets	<u>(2,040,167)</u>
Net cash used by capital and related financing activities	<u>(2,986,866)</u>
Cash flows from investing activities:	
Interest and dividends on investments	539,181
Proceeds from sale of investments	<u>(225,012)</u>
Net cash used by investing activities	<u>314,169</u>
Net increase in cash and cash equivalents	2,077,373
Cash and cash equivalents at beginning of year	<u>7,421,252</u>
Cash and cash equivalents at end of year	<u>\$ 9,498,625</u>
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents in current assets	\$ 3,773,819
Restricted cash and cash equivalents	<u>5,724,806</u>
Total cash and cash equivalents	<u>\$ 9,498,625</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 837,173
Adjustments to reconcile operating income to net cash flows provided in operating activities:	
Depreciation and amortization	3,155,477
Provision for bad debts	3,281,219
Nonoperating revenue	247,258
Gain on sale of equipment	47,066
Increase in current assets:	
Patient accounts receivable	(3,126,083)
Supplies and other current assets	(516,697)
Third-party settlements	(227,034)
Other assets	(51,900)
Increase in current liabilities:	
Accounts payable and accrued expenses	217,973
Other current liabilities	<u>885,618</u>
Net cash provided in operating activities	<u>\$ 4,750,070</u>

Noncash investing, capital, and financing activities:

The Hospital entered into capital lease obligations of \$1,152,251 for new equipment in 2006.

On December 5, 2006, the Daviess Community Hospital issued \$19,215,000 in refunding revenue bonds to refund \$16,880,000 of outstanding 1998 and 1999 serial bonds. The net proceeds of \$16,895,000 (after payment of \$838,772 in issuance costs and deposit of \$1,462,354 into a construction fund) were deposited in an irrevocable trust with an escrow agent. The accounting loss of \$788,211 has been recognized on the Balance Sheet as Deferral of Loss on Refunding and will be amortized using the straight line method and charged to amortization expense over the next 23 years.

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

Daviess Community 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 Daviess 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 Daviess County.

On October 19, 1967, the Board of County Commissioners of Daviess County, upon written request of the Hospital Board of Trustees created the Daviess Community Hospital Association. The Association was created pursuant to the provisions of Indiana Code 16-22-6 for the exclusive purpose of financing and constructing hospital facilities for the Hospital.

The accompanying financial statements present the activities of the Hospital (primary government) and its significant component units. The component units discussed below are included in the Hospital's reporting entity because of the significance of their operational or financial relationships 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 Units

The Health Services Development Foundation is a significant blended component unit of the Hospital. The primary government appoints a voting majority of the foundation's board and a financial benefit/burden relationship exists between the Hospital and the Foundation. Although it is legally separate from the Hospital, the foundation is reported as if it were a part of the Hospital because it provides services entirely or almost entirely to the Hospital.

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. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

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 ninety days.

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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.

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 assets.

2. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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
Land improvements	\$ 500	Straight-line	*
Buildings and improvements	500	Straight-line	*
Equipment	500	Straight-line	*

* Estimated lives have been assigned in accordance with the American Hospital association Uniform Chart of Accounts and the hospital's actual life experience.

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. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Net Assets

Net assets of the Hospital are classified in four components.

Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the hospital, including amounts deposited with trustees as required by revenue bond indentures, discussed in Note II-F.

Restricted nonexpendable net assets equal the principal portion of permanent endowments.

Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

D. Grants and Contributions

From time to time, the Hospital receives grants from Daviess 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. Endowments

Endowments are provided to the Hospital on a voluntary basis by individuals and private organizations. Permanent endowments require that the principal or corpus of the endowment be retained in perpetuity. If a donor has not provided specific instructions, state law permits the Hospital Board of Trustees to authorize for expenditure the net appreciation of the investments of endowment funds, as discussed in Note II-G.

F. 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.

G. Operating Revenues and Expenses

The Hospital's statement of revenues, expenses and changes in net assets 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.

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

H. Compensated Absences

The Hospital's policy on paid days off (which includes vacation, sick leave, and holidays) allows full-time employees and regular part-time employees to accrue paid days off, to a maximum of 520 hours.

Paid days off are accrued when incurred and reported as a liability.

II. Detailed Notes

A. Deposits and Investments

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 5-13-8-1 allows a political subdivision of the State of Indiana to deposit public funds in a financial institution only if the financial institution is a depository eligible to receive state funds; and has a principal office or branch that qualifies to receive public funds of the political subdivision. Balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories. Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

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

Receivable from patients and their insurance carriers	\$ 6,323,295
Receivable from medicare	5,007,007
Receivable from medicaid	<u>1,573,700</u>
 Total patient accounts receivable	 12,904,002
 Less allowance for uncollectible amounts	 <u>5,042,355</u>
 Patient accounts receivable, net	 <u><u>\$ 7,861,647</u></u>

Accounts Payable and Accrued Expenses

Payable to employees (including payroll taxes)	\$ 1,073,036
Payable to suppliers	<u>887,996</u>
 Total accounts payable and accrued expenses	 <u><u>\$ 1,961,032</u></u>

DAVISS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

C. Capital Assets

Capital asset activity for the year ended December 31, 2006, 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	\$ 751,101	\$ 419,383	\$ -	\$ 1,170,484
Construction in progress	<u>58,948</u>	<u>822,674</u>	<u>615,629</u>	<u>265,993</u>
 Total capital assets, not being depreciated	 <u>810,049</u>	 <u>1,242,057</u>	 <u>615,629</u>	 <u>1,436,477</u>
Capital assets, being depreciated:				
Land improvements	681,247	48,492	-	729,739
Buildings and improvements	35,347,317	264,697	-	35,612,014
Equipment	<u>18,763,587</u>	<u>2,482,362</u>	<u>729,389</u>	<u>20,516,560</u>
 Totals	 <u>54,792,151</u>	 <u>2,795,551</u>	 <u>729,389</u>	 <u>56,858,313</u>
Less accumulated depreciation for:				
Land improvements	343,346	10,049	-	353,395
Buildings and improvements	8,457,942	962,323	-	9,420,265
Equipment	<u>12,822,699</u>	<u>2,123,184</u>	<u>499,827</u>	<u>14,446,056</u>
 Totals	 <u>21,623,987</u>	 <u>3,095,556</u>	 <u>499,827</u>	 <u>24,219,716</u>
 Total capital assets, being depreciated, net	 <u>33,168,164</u>	 <u>(300,005)</u>	 <u>229,562</u>	 <u>32,638,597</u>
 Total primary government capital assets, net	 <u>\$ 33,978,213</u>	 <u>\$ 942,052</u>	 <u>\$ 845,191</u>	 <u>\$ 34,075,074</u>

D. Construction Commitments

Construction work in progress is composed of the following:

<u>Project</u>	<u>Total Project Authorized</u>	<u>Expended to December 31, 2006</u>
ICU remodeling, JCAHO improvements	<u>\$ 265,993</u>	<u>\$ 265,993</u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

E. Capital Lease

The Hospital has entered into a capital lease for a PACS system. Future minimum lease payments and present values of the net minimum lease payments under the capital leases as of year end December 31, 2006, are as follows:

2007	\$	258,409
2008		258,409
2009		258,409
2010		258,409
2011		<u>193,807</u>
Total minimum lease payments		1,227,443
Less amount representing interest		<u>126,473</u>
Present value of net minimum lease payments		<u>\$ 1,100,970</u>

Assets acquired through capital leases still in effect are as follows:

Equipment	\$	1,152,251
Accumulated depreciation		<u>96,021</u>
Equipment, net of depreciation		<u>\$ 1,056,230</u>

F. Long-Term Liabilities

1. Revenue Bonds

The Hospital issues bonds to be paid by income derived from the acquired or constructed assets. Revenue bonds outstanding at year end are as follows:

Purpose	Interest Rates	Amount
2001 Variable rate revenue bonds for hospital construction	Variable	\$ 3,776,400
2006 Refunding revenue bonds for hospital improvements	3.56%	<u>19,215,000</u>
Total		<u>\$ 22,991,400</u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Revenue bonds debt service requirements to maturity are as follows:

Year Ended December 31	Principal	Interest
2007	\$ 1,155,280	\$ 233,318
2008	1,220,280	811,768
2009	1,230,280	755,139
2010	1,360,280	697,704
2011	1,385,280	636,091
2012-2016	3,535,000	2,717,198
2017-2021	4,280,000	2,037,892
2022-2026	5,195,000	1,214,118
2027-2029	3,630,000	261,450
Totals	\$ 22,991,400	\$ 9,364,678

2. Advance Refunding

On December 5, 2006, the Daviess Community Hospital issued \$19,215,000 in refunding revenue bonds with an average interest rate of 4.13% to advance refund \$16,880,000 of outstanding 1998 and 1999 series bonds with an average interest rate of 5.99%. The net proceeds of \$16,895,000 (after payment of \$857,645 in issuance costs and deposit of \$1,462,354 to a construction fund) were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 1998 and 1999 series bonds. As a result, these bonds are considered to be defeased and the liability for those bonds has been removed from the Balance Sheet. The refunding resulted in the accounting loss of \$788,211, which has been recognized on the Balance Sheet as Deferral of Loss on Refunding. This amount will be amortized using the straight line method and charged to interest expense over the next 23 years. The Daviess Community Hospital in effect decreased its aggregate debt service payment by \$3,854,128 over the next 23 years and realized an economic gain (difference between the present values of the old and new debt service payments) of \$1,843,787.

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2006, was as follows:

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable:					
Revenue:					
Indiana Health Facility Financing Authority	\$ 21,801,680	\$ -	\$ 18,025,280	\$ 3,776,400	\$ 755,280
Other revenue bonds	-	19,215,000	-	19,215,000	400,000
Less deferred amount on refunding	<u>241,348</u>	<u>788,211</u>	<u>241,348</u>	<u>788,211</u>	<u>-</u>
Total bonds payable	21,560,332	18,426,789	17,783,932	22,203,189	1,155,280
Capital leases	<u>-</u>	<u>1,152,251</u>	<u>51,281</u>	<u>1,100,970</u>	<u>212,304</u>
Total long-term liabilities	<u>\$ 21,560,332</u>	<u>\$ 19,579,040</u>	<u>\$ 17,835,213</u>	<u>\$ 23,304,159</u>	<u>\$ 1,367,584</u>

4. Net Revenue Available for Debt Service

The following disclosures concerning net revenue available for debt service applicable to the years ended December 31, 2006, are required by terms of the financing agreement between the Hospital and IHFFA:

Revenue from operations	\$ 47,259,720
Investment income	539,181
Less:	
Expenses (excluding depreciation, amortization and interest on funded debt)	<u>42,039,577</u>
Total net revenue available for debt service	<u>\$ 5,759,324</u>
Funded debt service for year	<u>\$ 2,393,753</u>
Historical debt service coverage ratio	<u>2:1</u>

G. Endowments and Restricted Net Assets

Restricted nonexpendable net assets as of year end represent the principal amounts of permanent endowments, restricted to investment in perpetuity. Investment earnings from the Hospital's permanent endowments are expendable to support these programs as established by the contributor:

	<u>2006</u>
Robertson estate	\$ 540
Graham legacy	<u>1,450</u>
Total restricted nonexpendable net assets	<u>\$ 1,990</u>

DAVISS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

H. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were \$358,584 for 2006.

I. Internally Designated Assets

Noncurrent cash and investments internally designated include the following:

1. Funded Depreciation – Amounts transferred from the Operating Fund by the Hospital Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the Hospital buildings as authorized by Indiana Code 16-22-3-13.
2. Capital Improvement Funds – Funds designated by the Hospital Board of Trustees for construction and other capital improvement.
3. Designated Funds – Assets set aside by the Hospital Board of Trustees for identified purposes and over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Internally designated:	
Funded depreciation:	
Cash and cash equivalents	\$ 1,273,611
Investments	<u>5,754,444</u>
Total funded depreciation	<u>7,028,055</u>
Capital improvement:	
Cash and cash equivalents	36,011
Investments	<u>100,000</u>
Total capital improvement	<u>136,011</u>
Board designation:	
Cash and cash equivalents	114,997
Investments	<u>850,000</u>
Total board designation	<u>964,997</u>
Total internally designated	<u><u>\$ 8,129,063</u></u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); 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. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. There were no significant reductions in insurance by major category of risk.

Medical Benefits to Employees

The Hospital has chosen to establish a risk financing fund for risks associated with medical benefits to employees. The risk financing fund is accounted for in the Operating Fund, where assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of \$60,000 per year. Settled claims resulting from this risk did not exceed commercial insurance coverage in the past three years.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported (IBNRs).

Changes in the balance of claim liabilities during the past two years are as follows:

	2006	2005
Unpaid claims, beginning of fiscal year	\$ 254,147	\$ 181,025
Incurred claims and changes in estimates	2,122,129	2,050,822
Claim payments	(2,219,445)	(1,977,700)
Unpaid claims, end of fiscal year	\$ 156,831	\$ 254,147

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.

DAVISS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

C. Postemployment Benefits

In addition to the pension benefits described in Note III-F, the Hospital provides postemployment health insurance benefits, as authorized by Indiana Code 5-10-8, to all employees who retire from the Hospital on or after attaining age 62 with at least 10 years of service. Currently, 2 retirees meet these eligibility requirements. The Hospital provides 56% to 58% of these postemployment benefits. Expenditures for those postemployment benefits are recognized on a pay-as-you-go basis. Expenditures for postemployment benefits cannot be reasonably estimated.

D. 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 assets for cash and cash equivalents approximates its fair value.

Investments

Fair values, which are the amounts reported in the statement of net assets, 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 assets for accounts payable and accrued expenses approximates its fair value.

Estimated Third-Party Payor Settlements

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

E. Estimated Third-Party Settlements

Regulations in effect require annual retroactive settlements for third-party settlements based upon cost reports filed by the Hospital. These retroactive settlements are estimated and recorded in the accompanying financial statements. Changes in these estimates are reflected in the year in which they occur. During 2006, net patient service revenues in the accompanying statements of operations were increased by \$227,034, to reflect changes in the estimated settlements for certain prior years.

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

F. Pension Plan

Daviess Community Hospital Money Purchase Plan

Plan Description

The Hospital has a defined benefit pension plan administered by Principal Financial Group as authorized by Indiana Code 16-22-3-11. The plan provides retirement, disability, and death benefits to plan members and beneficiaries. The plan was established by written agreement between the Hospital Board of Trustees and the Plan Administrator. The Plan Administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan. That report may be obtained by contacting:

Principal Mutual Life Insurance Company
711 High Street
Des Moines, Iowa 50392-0001
Ph. (515)-247-5111

Information is not available to report additional disclosure required by GASB Statement No. 27.

DAVIESS COMMUNITY HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on April 25, 2007, with Eric Moll, Chairman of Hospital Board; Kenneth E. Parsons, Trustee member; Brad Hardcastle, Chief Financial Officer; and James Heckert, Executive Director. Our audit disclosed no material items that warrant comment at this time.