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**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, 2009 to December 31, 2009



**FILED**  
05/24/2010



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HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Executive Director	Gary L. Kendrick	01-01-09 to 12-31-10
Chief Financial Officer	Brad Hardcastle	01-01-09 to 12-31-10
Chairman of the Hospital Board	Kenneth Parsons	07-01-08 to 06-30-10
President of the Board of County Commissioners	Anthony B. Wichman	01-01-09 to 12-31-10



**STATE OF INDIANA**  
AN EQUAL OPPORTUNITY EMPLOYER

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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 the business-type activities of the Daviess Community Hospital (Hospital) as of and for the year ended December 31, 2009, which collectively comprise the Hospital's basic financial statements 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 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 includes consideration of internal control over financial reporting as a basis for designing 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 over reporting. 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 opinions.

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, 2009, 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 of America.

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 accounting principles generally accepted in the United States of America. 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

March 24, 2010



## *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, 2009. 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, 2009 while the Statement of Revenues, Expenses and Changes in Net Assets summarize 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 remained unchanged as a result of this year's operations.
- The Hospital's net operating revenues of \$49.9 million increased by \$1.0 million or 2.3% from prior year. Gross revenue for inpatients increased \$1.4 million while outpatient gross revenue increased \$2.4 million.
- The Hospital's operating expenses of \$50.2 million increased by \$0.7 million or 1.3% from the prior year. Salaries and benefits increased \$0.4 million, physician fees increased by \$0.7 million, interest decreased \$0.7 million, and bad debts increased \$0.8 million.

### ***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 2009 and Prior Year 2008. Related notes follow the financial reports.

NET ASSETS		
	2009	2008
Current Assets	\$10.3	\$12.6
Noncurrent Assets	12.7	12.9
Capital Assets	34.9	33.7
Total Assets	57.9	59.2
Current Liabilities	5.5	5.3
Long-Term Debt	17.0	18.6
Total Liabilities	22.5	23.9
Net Assets		
Invested in Capital Assets	16.3	13.6
Restricted	3.1	3.4
Unrestricted	16.0	18.4
Total Net Assets	\$35.4	\$35.4

Current Assets of \$10.3 million decreased \$2.3 million or 18.3% from the prior year. Net receivables declined \$1.0 million and cash declined by \$1.2 million. We are in the process of installing a new computer system and have paid \$2.3 million of the \$4.2 million total cost.

Long-Term Debt of \$17.0 million decreased \$1.6 million or 8.6% from the prior year.

CHANGES IN NET ASSETS		
	2009	2008
<b>Revenue</b>		
Net Patient Service Revenue	\$48.8	\$47.9
Other Revenues	1.1	0.9
Total Revenues	49.9	48.8
<b>Expenses</b>		
Salaries and Benefits	26.1	25.7
Medical Supplies and Drugs	3.9	4.2
Insurance	0.6	0.6
Other Supplies	1.2	1.3
Depreciation and Amortization	2.7	2.7
Other Expenses	15.7	15.0
Total Expenses	50.2	49.5
Operating Loss	-0.3	-0.7
Non-operating Revenues	0.3	0.5
Increase (Decrease) In Net Assets	0.0	-0.1
Net Assets Beginning of the Year	35.4	35.5
Net Assets End of the Year	\$35.4	\$35.4

Net assets at the end of the year remained stable for calendar year 2009. Net assets are the difference between net patient service revenues and the expenses incurred to perform those services.

The primary components for net assets in 2009 are:

- The Hospital's net operating revenues of \$49.9 million increased by \$1.1 million or 2.3% from prior year. Inpatient service revenue increased 4.3% and outpatient revenue increased 4.5%.
- The Hospital's operating expenses of \$50.2 million increased by \$0.7 million or 1.4% from prior year. Salaries and benefits increased \$0.4 million, physician fees increased by \$0.7 million, interest decreased \$0.7 million, and bad debts increased \$0.8 million. Self pay revenue increased \$1.0 million or 15% in 2009.

## ***Capital Assets and Debt Administration***

### ***Capital Assets***

At the end of 2009, the Hospital had \$34.9 million invested in capital assets. The Hospital had a net increase of \$1.2 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, 2009.

Capital Assets at Year-End Net of Depreciation		
	2009	2008
Land	\$1.2	\$1.2
Land Improvements/Leasehold Improvements	0.8	0.8
Building	38.3	37.9
Equipment	21.9	22.4
Total	62.2	62.3
Less Accumulated Depreciation	29.5	29.1
Subtotal	32.7	33.2
Construction In Progress	2.2	0.5
Capital Assets (Net)	\$34.9	\$33.7

### ***Debt***

At year-end, the Hospital had approximately \$19.8 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		
	2009	2008
Variable Rate Hospital Revenue Bonds		
2001 Revenue Bonds	\$1.5	\$2.3
Indiana Health Facility Financing Authority (IHFFA)		
1998/1999 Revenue Bonds	0.0	0.1
2006 Revenue Bond (Refunded 1998 and 1999 series)	17.9	18.4
PACS Capital Lease	0.4	0.7
Total Debt	\$19.8	\$21.4

### ***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.

DAVIESS COMMUNITY HOSPITAL  
STATEMENT OF NET ASSETS  
December 31, 2009

Assets

Current assets:	
Cash and cash equivalents	\$ 117,830
Patient accounts receivable, net of estimated uncollectibles of \$4,635,390	6,101,268
Supplies and other current assets	3,250,494
Noncurrent cash and investments:	
Internally designated	9,624,352
Held by trustee for debt service	3,094,923
Capital assets:	
Land and construction in progress	3,437,929
Depreciable capital assets, net of accumulated depreciation	31,426,540
Other assets	<u>861,182</u>
 Total assets	 <u>\$ 57,914,518</u>

Liabilities and Net Assets

Current liabilities:	
Current maturities of long-term debt	\$ 1,618,689
Accounts payable and accrued expenses	2,609,922
Other current liabilities	1,312,299
Long-term debt, net of current maturities	<u>16,990,286</u>
 Total liabilities	 <u>22,531,196</u>
Net assets:	
Invested in capital assets, net of related debt	16,255,494
Restricted:	
For debt service	3,094,923
Unrestricted	<u>16,032,905</u>
 Total net assets	 <u>35,383,322</u>
 Total liabilities and net assets	 <u>\$ 57,914,518</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, 2009

Operating revenues:	
Net patient service revenue (net of provision for bad debt)	\$ 48,828,386
Other	<u>1,062,988</u>
Total operating revenues	<u>49,891,374</u>
Operating expenses:	
Salaries and benefits	26,155,647
Medical supplies and drugs	3,933,475
Insurance	570,119
Other supplies	1,204,515
Other expenses	15,719,224
Depreciation and amortization	<u>2,608,393</u>
Total operating expenses	<u>50,191,373</u>
Operating loss	<u>(299,999)</u>
Nonoperating revenues:	
Investment income	251,055
Gain on sale of equipment	1,490
Other	<u>79,687</u>
Total nonoperating revenues	<u>332,232</u>
Decrease in net assets	32,233
Net assets beginning of the year	<u>35,351,089</u>
Net assets end of the year	<u>\$ 35,383,322</u>

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

DAVIESS COMMUNITY HOSPITAL  
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS  
Year Ended December 31, 2009

	2009
Cash flows from operating activities:	
Receipts from and on behalf of patients	\$ 49,801,966
Payments to suppliers and contractors	(5,579,727)
Payments to employees	(26,155,647)
Other receipts and payments, net	(13,666,335)
Net cash provided by operating activities	4,400,257
Cash flows from capital and related financing activities:	
Principal paid on long-term debt	(1,562,955)
Interest paid on long-term debt	(838,520)
Purchase of capital assets	(3,680,240)
Net cash used by capital and related financing activities	(6,081,715)
Cash flows from investing activities:	
Interest and dividends on investments	251,055
Net increase in cash and cash equivalents	(1,430,403)
Cash and cash equivalents at beginning of year	7,717,508
Cash and cash equivalents at end of year	\$ 6,287,105
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents in current assets	\$ 117,830
Restricted cash and cash equivalents	6,169,275
Total cash and cash equivalents	\$ 6,287,105
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (299,999)
Adjustments to reconcile operating loss to net cash flows used in operating activities:	
Depreciation and amortization	2,608,393
Provision for bad debts	4,075,183
Other nonoperating revenues	79,687
Gain on sale of equipment	1,490
(Increase) decrease in current assets:	
Patient accounts receivable	(3,101,603)
Supplies and other current assets	34,948
Other assets	3,512
Increase in current liabilities:	
Accounts payable and accrued expenses	93,434
Other current liabilities	905,212
Net cash provided in operating activities	\$ 4,400,257

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 out-patient 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. Discretely presented component units are involved in activities of an operational nature independent from the government; their transactions are reported in a separate column in the basic financial statements to emphasize that it is legally separate from the Hospital.

Management has chosen to omit from these financial statements component units that have significant operational or financial relationships with the Hospital. Accordingly, the financial statements do not include the data of all of the Hospital's component units necessary for reporting in conformity with accounting principles generally accepted in the United States.

Blended Component Units

The Daviess Community Hospital Foundation (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.

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

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.

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as non-operating 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.

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

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.

4. Net Assets

Net assets of the Hospital are classified in three 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. H.

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. 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 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.

G. 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 265 hours.

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

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

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	\$ 6,535,553
Receivable from Medicare	3,356,466
Receivable from Medicaid	<u>844,639</u>
 Total patient accounts receivable	 10,736,658
 Less allowance for uncollectible amounts	 <u>4,635,390</u>
 Patient accounts receivable, net	 <u>\$ 6,101,268</u>

Accounts Payable and Accrued Expenses

Payable to employees (including payroll taxes)	\$ 1,199,042
Payable to suppliers	<u>1,410,880</u>
 Total accounts payable and accrued expenses	 <u>\$ 2,609,922</u>

DAVISS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

C. Capital Assets

Capital asset activity for the year ended December 31, 2009, 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	\$ 1,232,668	\$ -	\$ -	\$ 1,232,668
Construction in progress	<u>521,234</u>	<u>2,408,703</u>	<u>724,676</u>	<u>2,205,261</u>
Total capital assets, not being depreciated	<u>1,753,902</u>	<u>2,408,703</u>	<u>724,676</u>	<u>3,437,929</u>
Capital assets, being depreciated:				
Land improvements	775,430	1	-	775,431
Buildings and improvements	37,881,367	449,167	-	38,330,534
Equipment	<u>22,360,896</u>	<u>1,582,363</u>	<u>2,035,921</u>	<u>21,907,338</u>
Totals	<u>61,017,693</u>	<u>2,031,531</u>	<u>2,035,921</u>	<u>61,013,303</u>
Less accumulated depreciation for:				
Land improvements	384,382	18,417	-	402,799
Buildings and improvements	11,358,246	1,048,663	-	12,406,909
Equipment	<u>17,337,004</u>	<u>1,440,653</u>	<u>2,000,602</u>	<u>16,777,055</u>
Totals	<u>29,079,632</u>	<u>2,507,733</u>	<u>2,000,602</u>	<u>29,586,763</u>
Total capital assets, being depreciated, net	<u>31,938,061</u>	<u>(476,202)</u>	<u>35,319</u>	<u>31,426,540</u>
Total primary government capital assets, net	<u>\$ 33,691,963</u>	<u>\$ 1,932,501</u>	<u>\$ 759,995</u>	<u>\$ 34,864,469</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, 2009</u>	<u>Required Future Funding</u>
Accudose Project	\$ 516,955	\$ 1,768	\$ 515,187
IT Project	2,613,742	1,525,893	1,087,849
Capital Equipment	513,040	513,040	-
Wireless Project	<u>169,000</u>	<u>164,560</u>	<u>\$ 4,440</u>
Totals	<u>\$ 3,812,737</u>	<u>\$ 2,205,261</u>	<u>\$ 1,607,476</u>

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

E. Leases

1. Operating Leases

The hospital has entered into various operating leases having initial or remaining noncancelable terms exceeding one year for IV Pumps and a Bulk Oxygen Tank. Rental expenditures for these two leases were \$4,251 and \$4,250, respectively. The following is a schedule by years of future minimum rental payments as of yearend:

2010	\$ 61,213
2011	61,214
2012	61,213
2013	61,214
2014-2018	97,762
2019-2023	5,950
Total minimum rental payments	<u>\$ 350,566</u>

2. Capital Leases

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 lease as of December 31, 2009, are as follows:

2010	\$ 258,409
2011	<u>193,807</u>
Total minimum lease payments	452,216
Less amount representing interest	<u>18,482</u>
Present value of net minimum lease payments	<u>\$ 433,734</u>

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

Equipment	\$ 1,152,251
Accumulated depreciation	<u>787,371</u>
Total	<u>\$ 364,880</u>

DAVISS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

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	\$ 1,510,560
2006 Refunding revenue bonds for hospital improvements	Variable	<u>17,875,000</u>
Total		<u>\$ 19,385,560</u>

Revenue bonds debt service requirements to maturity are as follows:

Year Ended December 31	Principal	Interest
2010	1,360,280	863,056
2011	1,385,280	799,957
2012	655,000	751,630
2013	680,000	720,973
2014	710,000	689,061
Thereafter:		
2015-2019	3,815,000	3,102,077
2020-2024	4,805,000	1,919,705
2025-2029	<u>5,975,000</u>	<u>724,543</u>
Totals	<u>\$ 19,385,560</u>	<u>\$ 9,571,002</u>

2. Advance Refunding

In prior years, the Hospital defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments of the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Hospital's financial statements. The following outstanding bonds, at December 31, 2009, were considered defeased:

	Amount
Hospital	<u>\$ 15,225,000</u>

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2009, was as follows:

<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:					
Hospital association	\$ 2,265,840	\$ -	\$ 755,280	\$ 1,510,560	\$ 755,280
Indiana Health Facility Financing Authority	100,000	-	100,000	-	-
Other revenue bonds	18,350,000	-	475,000	17,875,000	605,000
Less deferred amount on refunding	<u>1,270,999</u>	<u>-</u>	<u>60,680</u>	<u>1,210,319</u>	<u>-</u>
Total bonds payable	19,444,841	-	1,269,600	18,175,241	1,360,280
Capital leases	<u>666,410</u>	<u>-</u>	<u>232,675</u>	<u>433,734</u>	<u>258,409</u>
Total long-term liabilities	<u>\$ 20,111,251</u>	<u>\$ -</u>	<u>\$ 1,502,275</u>	<u>\$ 18,608,975</u>	<u>\$ 1,618,689</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, 2009, are required by terms of the financing agreement between the Hospital and IHFFA:

Revenue from operations	\$ 49,891,374
Investment income	251,055
Net gain on disposal of assets	1,490
Less:	
Expenses (excluding depreciation, amortization and interest on funded debt)	<u>46,744,460</u>
Total net revenue available for debt service	<u>\$ 3,399,459</u>
Funded debt service for year	<u>\$ 2,401,475</u>
Historical debt service coverage ratio	<u>1.42</u>

G. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were \$1,115,273 for 2009.

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

H. 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 IC 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	\$ 2,304,203
Investments	6,550,000
Total funded depreciation	<u>8,854,203</u>
Capital improvement:	
Cash and cash equivalents	<u>38,084</u>
Board designation:	
Cash and cash equivalents	<u>732,065</u>
Total internally designated	<u><u>\$ 9,624,352</u></u>

I. Net Patient Services 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 an inpatient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services and defined capital costs related to the 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 an annual cost report by the Hospital and audits thereof by the Medicare fiscal intermediary.

DAVISS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

2. Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a fee schedule methodology with no settlement process.

Revenue from the Medicare and Medicaid programs accounted for approximately 40.5% and 8.2%, respectively, of the Hospital's net patient revenue for the year ended 2009, and 39.7% and 8.3%, respectively, of the Hospital's net patient revenue for the year ended 2008. 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 2009 net patient service revenue increased approximately \$226,495 as a result of interim settlements for prior years.

The Hospital also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Hospital under these agreements are discounts from established charges.

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; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); 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 \$70,000 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). Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of payouts and other economic and social factors.

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

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

	2009	2008
Unpaid claims, beginning of fiscal year	\$ 184,689	\$ 140,245
Incurred claims and changes in estimates	2,469,018	2,388,100
Claim payments	(2,449,576)	(2,343,656)
 Unpaid claims, end of fiscal year	 \$ 204,131	 \$ 184,689

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. Postemployment Benefits

In addition to the pension benefits described in Note III. G., the Hospital provides postemployment health insurance benefits, as authorized by IC 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, four 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. During the year ended December 31, 2009, expenditures of \$2,393 were recognized for postemployment benefits.

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.

Short-Term Investments

The carrying amount reported in the Statement of Net Assets is the investment's fair value on the day it becomes a short-term investment.

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.

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

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.

E. Fair Value Measurements

Statement on Financial Accounting Standards No. 157, Fair Value Measurements (as amended), requires certain disclosures regarding the fair value of financial instruments. Financial instruments held by the Hospital impacted by this pronouncement include the Hospital's investments and assets whose use is limited which are measured using quoted prices in active markets and other significant observable inputs.

The Hospital partially adopted the provisions of FAS 157 for fiscal year 2008, but will delay adoption of nonfinancial assets and nonfinancial liabilities covered by FASB Staff Position No. FAS 157-2. This Staff Position permits entities to partially defer the effective date of FAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, until fiscal year 2009.

When fully adopted, the Hospital will apply the provisions of FAS 157-2 to certain nonfinancial assets and liabilities and is currently evaluating the impact of the full adoption of this statement on the activities, changes in net assets and financial position. Using the provisions within SFAS No. 157, the Hospital has characterized its investments in securities, based on the priority of the inputs used to value the investments, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities [Level 1], and the lowest priority to unobservable inputs [Level 3]. If the inputs used to measure the investments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the investment.

Investments recorded in the statement of financial position are categorized based on the inputs to valuation techniques as follows:

*Level 1* - These are investments where values are based on unadjusted quoted prices for identical assets in an active market the Hospital has the ability to access. Investments include mutual funds.

*Level 2* - These are investments where values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the investments. These investments are comprised of U.S. government securities that trade infrequently and certificates of deposit.

*Level 3* - These are investments where values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect assumptions of management about assumptions market participants would use in pricing the investments.

DAVIESS COMMUNITY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

Based upon the levels as defined the Hospital's investments as of December 31, 2009 are classified as follows:

Investment type	December 31,	Fair value measurements at reporting date using:		
		Quoted prices in active markets identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Certificates of deposit	\$ 6,550,000	\$ -	\$ 6,550,000	\$ -

F. 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 2008, net patient service revenues in the accompanying statements of operations were increased by \$55,890, to reflect changes in the estimated settlements for certain prior years.

G. 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 IC 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, IA 50392-0001  
Ph. (515) 247-5111

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

DAVIESS COMMUNITY HOSPITAL  
AUDIT RESULTS AND COMMENTS

ACCOUNTS PAYABLE

During the review of accounts payable in the prior audit, the Laboratory Manager at Daviess Community Hospital creates a purchase order to generate an account payable at the end of the month. However, when the actual order is placed in the next month for the inventory or supply, a new purchase order is created by the Manager.

When reviewing the December 31, 2009, Payables report, Batch 3, there were three open purchase orders from the laboratory totaling \$25,370; however, the invoices for these open orders had already been paid in December 2009. This procedure of accruing expenses by estimate by the laboratory and not reconciling with the actual invoices resulted in overstatement of accounts payable at December 31, 2009.

Five claims tested were paid past the due date of the invoices, in the amount of \$229,892. Of these past due invoices, \$212,228, were for capital assets and processed late due to the procedures of materials management. The purchase orders for capital assets are closed and invoices paid after the materials manager enters the information on his spreadsheet, not when the assets are actually received, which attributes to the staleness of the payments.

Two claims tested were rent invoices for January 2010, which should not have been accrued as a part of the accounts payable balance for December 31, 2009.

Governmental units should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are necessary for proper internal control. (Accounting and Uniform Compliance Guidelines Manual for County and City Hospitals, Chapter 1)

CORRECTION OF ERRORS - CASH ACCOUNT

The cash account on the hospital's general ledger was adjusted by \$1,736.63 on December 31, 2009, to enable reconciliation with the bank account. The entry lowered the cash account balance by \$1,736.63 without supporting documentation as to why the entry was made. The entry was basically a "cash necessary to balance" to the reconciled bank accounts. It was also noted that reconciliements were not performed on a timely basis, thus the hospital was unable to correct reconciliation errors when they occurred.

DAVIESS COMMUNITY HOSPITAL  
AUDIT RESULTS AND COMMENTS  
(Continued)

Receipt and disbursement corrections or other errors should be corrected by memorandum entry with the issuance of a check and receipt to document the flow of the transactions. (Accounting and Uniform Compliance Guidelines Manual for County and City Hospitals, Chapter 1)

To provide for adequate safeguarding of cash and to enable the hospital to identify and correct errors on a timely basis, a reconciliation of the account balances recorded in the accounting records to the balances of the depository accounts should be performed by the hospital at least monthly. (Accounting and Uniform Compliance Guidelines Manual for County and City Hospitals, Chapter 9)

INTERNAL CONTROLS

Controls for disbursements generated by the accounts payable department were insufficient. The Board does not approve checks before printing and mailing. The Board approved the monthly accounts payable on a consent agenda after the fact. There was no dollar amount associated with the consent agenda approved per the Board minutes.

Governmental units should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are necessary for proper internal control.

Controls over the receipting, disbursing, recording and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements and incorrect decision making. (Accounting and Uniform Compliance Guidelines Manual for County and City Hospitals, Chapter 1)

DAVISS COMMUNITY HOSPITAL  
EXIT CONFERENCE

The contents of this report were discussed on March 24, 2010, with Gary L. Kendrick, Executive Director; Brad Hardcastle, Chief Financial Officer; and Anthony R. Showalter, Vice-President of Hospital Board.