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April 30, 2013

Board of Directors
Sullivan County Community Hospital
2200 N. Section Street
Sullivan, IN 47882

We have reviewed the audit report prepared by BKD, LLP Independent Public Accountants, for the period January 1, 2012 to December 31, 2012. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Sullivan County Community Hospital, as of December 31, 2012 and the results of its operations for the period then ended, on the basis of accounting described in the report.

The Independent Public Accountants' report is filed with this letter in our office as a matter of public record.

STATE BOARD OF ACCOUNTS

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana

Auditor's Report and Financial Statements

December 31, 2012

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
December 31, 2012

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Independent Auditor's Report on Financial Statements and Supplementary Information

Board of Trustees
Sullivan County Community Hospital
Sullivan, Indiana

We have audited the accompanying financial statements of Sullivan County Community Hospital (Hospital), and its discretely presented component unit, collectively, a component unit of Sullivan County, Indiana, as of and for the year ended December 31, 2012, 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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sullivan County Community Hospital, a component unit of Sullivan County, Indiana, and of its discretely presented component unit as of December 31, 2012, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

The 2011 financial statements, before they were restated for the matter discussed in Note 12, were audited by other auditors and their report thereon, dated May 2, 2012, expressed an unmodified opinion.

As part of our audit of the 2012 financial statements, we also audited the adjustment described in Note 12 that was applied to restate the 2011 financial statements. In our opinion, such adjustment is appropriate and has been properly applied. We were not engaged to audit, review or apply any procedures to the 2011 financial statements of the Hospital other than with respect to the adjustment and, accordingly, we do not express an opinion or any other form of assurance on the 2011 financial statements as a whole.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BKD, LLP

Indianapolis, Indiana
February 27, 2013

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

Management's Discussion and Analysis

Year Ended December 31, 2012

Introduction

This management's discussion and analysis of the financial performance of Sullivan County Community Hospital (Hospital) provides an overview of the Hospital's financial activities for the year ended December 31, 2012. It should be read in conjunction with the accompanying financial statements of the Hospital. Unless otherwise indicated, amounts are in thousands.

Financial Highlights

- Cash and investments increased in 2012 by \$1,280,972 or 9.1%.
- The Hospital's net position increased in 2012 by \$1,917,717 of 6.8%.
- The Hospital reported operating income in both 2012 (\$1,797,596) and 2011 (\$819,969). The operating income in 2012 increased by \$977,627 or 119.2%, over the operating income reported in 2011.
- Net nonoperating revenues of \$120,121 in 2012 increased by \$248,868 or 177.4% compared to net nonoperating expenses of \$128,747 in 2011.

Using This Annual Report

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

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

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

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

The Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments, and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash and cash equivalents during the reporting period.

The Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the balance sheets. The Hospital's net position increased by \$1,917,717 or 6.8% in 2012 over 2011 as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2012	2011 Restated
Assets		
Patient accounts receivable, net	\$ 2,548,719	\$ 2,687,283
Other current assets	4,326,957	2,100,021
Capital assets, net	13,970,852	15,004,521
Other noncurrent assets	12,411,039	12,710,553
	<u>\$ 33,257,567</u>	<u>\$ 32,502,378</u>
Liabilities		
Long-term debt	\$ -	\$ 990,000
Other current and noncurrent liabilities	3,141,521	3,314,049
Total liabilities	<u>3,141,521</u>	<u>4,304,049</u>
Net Position		
Net investment in capital assets	\$ 13,970,852	\$ 14,014,521
Restricted	-	785,765
Unrestricted	16,145,194	13,398,043
Total net position	<u>30,116,046</u>	<u>28,198,329</u>
Total liabilities and net position	<u>\$ 33,257,567</u>	<u>\$ 32,502,378</u>

A significant change in the Hospital's assets in 2012 is the decrease in patient accounts receivable. Although net patient service revenues increased in 2012 by \$3,185,339 or 13.9% as compared to 2011, net patient accounts receivable decreased by \$138,564 or approximately 2 days of revenue at December 31, 2012, versus December 31, 2011. The decrease results primarily from increased patient service revenue and associated payments from the state Medicaid program under the state specific provider assessment program implemented during 2012, and improvements in filing claims with other third-party payers.

The most significant change in the Hospital's financial position in 2012 was the increase in cash and investments due to improved collections on accounts receivable discussed above, and positive operating results during 2012.

Additionally, during 2012, the Hospital paid off all outstanding bonds in advance of maturity. Outstanding debt associated with these bonds at December 31, 2011 was \$990,000.

Operating Results and Changes in the Hospital's Net Position

In 2012, the Hospital's net position increased by \$1,917,717 or 6.8%, as shown in Table 2. This increase is made up of several different components and represents an increase of 177.4% compared with the increase in net position for 2011 of \$691,222.

Table 2: Operating Results and Changes in Net Position

	2012	2011 Restated
Operating Revenues		
Net patient service revenue	\$ 26,166,666	\$ 22,981,327
Other operating revenues	122,445	118,451
Total operating revenues	<u>26,289,111</u>	<u>23,099,778</u>
Operating Expenses		
Salaries and wages and employee benefits	13,186,938	12,746,087
Purchased services and professional fees	3,226,248	3,032,369
Depreciation and amortization	1,739,034	1,619,233
Other operating expenses	6,339,295	4,882,120
Total operating expenses	<u>24,491,515</u>	<u>22,279,809</u>
Operating Income	<u>1,797,596</u>	<u>819,969</u>
Nonoperating Revenues (Expenses)		
Investment income	130,727	145,804
Interest expense	(3,182)	(26,174)
Other	(7,424)	(248,377)
Total nonoperating revenues (expenses)	<u>120,121</u>	<u>(128,747)</u>
Increase in Net Position	<u>\$ 1,917,717</u>	<u>\$ 691,222</u>

Operating Income

The first component of the overall change in the Hospital's net position is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In each of the past two years, the Hospital has reported an operating income. This is consistent with the Hospital's recent operating history as the Hospital was formed and is operated primarily to serve residents of Sullivan County and the surrounding area. The Hospital implements strong cost controls to provide sufficient resources to enable the facility to serve lower income and other residents.

The operating income for 2012 increased by \$977,627 or 119.2%, as compared to 2011. The primary components of the increased operating income are:

- An increase in net patient service revenue of \$3,185,339 or 13.9%.
- An increase in salaries, wages and benefits for the Hospital's employees of \$440,851 or 3.5%.
- An increase in other operating expenses of \$1,457,175 or 29.8%.

Net patient service revenue increased because of an increase in outpatient visits by approximately 4% from 2011 to 2012. Additionally, during 2012, Indiana implemented a new supplemental payment mechanism for the Medicaid program. This change resulted in additional patient revenue of approximately \$2.4 million. Supplemental Medicaid revenue recognized in 2012 was approximately \$3.1 million compared to approximately \$700,000 in 2011. This increase was partially offset by the additional provider assessment fee of \$1.3 million paid beginning in 2012, which is reflected as an operating expense as noted below.

Employee salaries and wages and benefits increased in 2012 in connection with the Hospital's retention and recruitment efforts. These efforts result primarily from the shortage of nurses and other health care professionals in the United States.

The rate of health care inflation has a direct effect on the cost of services provided by the Hospital. Expenditures for supplies and prescription drugs are a major component of the Hospital's costs. In 2012, supplies and prescription drug costs totaled \$2,445,731, or 10.0%, of total operating expenses. In 2011, they totaled \$2,492,637, or 11.2%, of total operating expenses, a decrease of \$46,906, or 1.9%, over 2011.

Operating income for 2012 of \$1,797,596 was an increase in operating income of \$819,969 recognized in 2011. The increase in net patient service revenue of \$3,185,337 was offset by increases in employee salaries and wages and increases. The increase in other operating expenses of \$1,457,175 was primarily related to payments made under the newly implemented state specific provider assessment program. During 2012, the Hospital recognized \$1,342,276 of assessment fees paid into the supplemental Medicaid program.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income, interest expense, rental income on Hospital owned property and payments made to subsidize the Hospital's discretely presented component unit. Investment income and rental income remained relatively constant in 2012 as compared to 2011. Interest expense decreased as a result of the Hospital paying off its outstanding long-term debt during 2012. Payments made to subsidize the Hospital's discretely presented component unit decreased by \$202,184 in 2012 as compared to 2011.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating income and nonoperating revenues and expenses for 2012 and 2011, discussed earlier.

Capital Asset and Debt Administration

Capital Assets

At the end of 2012, the Hospital had \$13,970,852 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. In 2012, the Hospital purchased new equipment costing \$795,422. The majority of these purchases were related to the Hospital's investment in electronic medical record software and equipment.

Debt

During 2012, the Hospital had paid all amounts outstanding on its revenue bonds in advance of their contractual maturity dates. The Hospital issued no new debt in 2012 or 2011, and has no outstanding debt as of December 31, 2012.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to Hospital Administration by telephoning (812) 268-4311.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Balance Sheet
December 31, 2012

Assets

Current Assets

Cash	\$ 3,101,196	
Patient accounts receivable, net of allowance of \$1,813,600	2,548,719	
Supplies	468,736	
Prepaid expenses and other current assets	<u>757,025</u>	
Total current assets		\$ 6,875,676

Noncurrent Cash and Investments - Funded depreciation 12,323,879

Capital Assets 13,970,852

Other Assets 87,160

Total assets \$ 33,257,567

Liabilities and Net Position

Current Liabilities

Accounts payable	\$ 631,495	
Accrued expenses	1,600,952	
Estimated amounts due to third-party payers	<u>909,074</u>	
Total current liabilities		\$ 3,141,521

Net Position

Net investment in capital assets	13,970,852	
Unrestricted	<u>16,145,194</u>	
Total net position		<u>30,116,046</u>

Total liabilities and net position \$ 33,257,567

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
SCCH Fitness Center, Inc.
Statement of Financial Position
December 31, 2012

Assets

Property and equipment, net of accumulated depreciation
of \$613,854

\$ 627,665

Total assets

\$ 627,665

Liabilities and Net Assets

Liabilities

Accrued expenses

\$ 22,370

Net Assets - Unrestricted

605,295

Total liabilities and net assets

\$ 627,665

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Statement of Revenues, Expenses and Changes in Net Position
Year Ended December 31, 2012

Operating Revenues

Net patient service revenue, net of provision for uncollectible accounts of \$4,705,258	\$ 26,166,666	
Other	122,445	
	<hr/>	
Total operating revenues		\$ 26,289,111

Operating Expenses

Salaries and wages	10,377,943	
Employee benefits	2,808,995	
Purchased services and professional fees	3,226,248	
Supplies	2,445,731	
Utilities	401,070	
Repair and maintenance	987,631	
Leases and rentals	264,523	
Insurance	292,008	
Depreciation and amortization	1,739,034	
Other	606,056	
Provider hospital assessment fee	1,342,276	
	<hr/>	
Total operating expenses		<hr/> 24,491,515

Operating Income

1,797,596

Nonoperating Revenues (Expenses)

Investment income	130,727	
Interest expense	(3,182)	
Other	(7,424)	
	<hr/>	
Total nonoperating revenues (expenses)		<hr/> 120,121

Increase in Net Position

1,917,717

Net Position, Beginning of Year, as previously reported

29,364,555

Adjustments applicable to prior years

(1,166,226)

Net Position, Beginning of Year, as restated

28,198,329

Net Position, End of Year

\$ 30,116,046

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
SCCH Fitness Center, Inc.
Statement of Activities
Year Ended December 31, 2012

Revenues, Gains and Other Support		
Membership, training, class and other revenue	\$ 220,900	
Operating support from the Hospital	103,530	
Total revenues, gains and other support	<u>324,430</u>	\$ 324,430
Expenses		
Salaries and wages	173,148	
Employee benefits	89,536	
Purchased services	24,101	
Supplies	4,654	
Utilities	18,164	
Repair and maintenance	9,434	
Depreciation	59,165	
Other	6,851	
Total expenses	<u>385,053</u>	<u>385,053</u>
Change in Net Assets		(60,623)
Unrestricted Net Assets, Beginning of Year , as previously reported	(500,308)	
Adjustments applicable to prior years	1,166,226	
Unrestricted Net Assets, Beginning of Year , as restated	<u>665,918</u>	<u>665,918</u>
Unrestricted Net Assets, End of Year		<u>\$ 605,295</u>

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2012

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

Nature of Operations and Reporting Entity

Sullivan County Community Hospital (Hospital) is an acute care hospital located in Sullivan, Indiana. The Hospital is a component unit of Sullivan County (County) and the Board of County Commissioners appoints members to the Governing Board of the Hospital pursuant to the provisions of Indiana Code 16-22-2-2. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Sullivan County surrounding area. It also operates a home health agency in the same geographic area.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses.

During 2012, the Hospital adopted Statement of Governmental Accounting Standards Board (GASB) No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in 7 of that Statement to apply post-November 30, 1989, FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. This Statement has been applied retrospectively and had no impact on the Hospital's net position, changes in net position or financial reporting disclosures.

During 2012, the Hospital also adopted Statement of Governmental Accounting Standards Board (GASB) No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement has been applied retrospectively and had no impact on the Hospital's net position, changes in net position or financial reporting disclosures other than changing terminology from net assets to net position.

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

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2012

Risk Management

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

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

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income includes dividend and interest income and the net change for the year in the fair value of investments carried at fair value.

Patient Accounts Receivable

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

Supplies

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

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2012

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. The following estimated useful lives are being used by the Hospital:

Land improvements	5 - 20 years
Buildings and leasehold improvements	10 - 20 years
Equipment	3 - 10 years

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense and the related liability for sick leave benefits are recognized to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date, plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date. The estimated compensated absences liability are expected to be paid within one year of the balance sheet date and is therefore included in current liabilities.

Net Position

Net position of the Hospital is classified in two components. Net investment in capital assets, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Unrestricted net position are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were \$138,607 for 2012.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2012

Income Taxes

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

The Fitness Center is exempt from federal income taxes under Section 501(c)(3) and 509(a)(2) of the U.S. Internal Revenue Code and a similar provision of state law. However, the Fitness Center is subject to federal income tax on any unrelated business taxable income. The Fitness Center files federal tax returns in the U.S. federal jurisdiction.

SCCH Fitness Center

SCCH Fitness Center, Inc. (Fitness Center) is a legally separate, tax-exempt component unit of the Hospital. The Fitness Center's primary function is to provide community access to health and fitness equipment. The Hospital appoints a voting majority of the Fitness Center's board and a financial relationship exists where the Hospital subsidizes the operations of the Fitness Center. Because of this relationship, the Fitness Center is considered a component unit of the Hospital and is discretely presented in the Hospital's financial statements.

During the year ended December 31, 2012, the Hospital provided \$103,530 of support to the Fitness Center.

Note 2: Net Patient Service Revenue

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

Medicare. The Hospital is designated by Medicare as a critical access hospital (CAH). Inpatient acute care and swing bed services, and most outpatient services, are reimbursed based on a cost reimbursement methodology. Interim per diem rates for inpatient services and percent of charges for outpatient services are reimbursed throughout the year, with final settlement determined after submission of the annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

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

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2012

Approximately 53 percent of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2012. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital received approximately \$2.9 million during 2012 due to the enactment of a state specific provider assessment program to increase Medicaid payments to hospitals. This revenue is recorded within net patient service revenue in the statement of revenues, expenses and changes in net position for 2012. Approximately \$890,000 of these increased payments were related to the Hospital's fiscal year 2011. The Hospital paid approximately \$1.3 million into this Medicaid program, which is recorded as an operating expense in the statement of revenues, expenses and changes in net position. Approximately \$450,000 of the payments to the Medicaid program were related to the Hospital's fiscal year 2011 but are included in 2012 as a result of when the assessment program was approved. There is no assurance this program will continue to be implemented in the future.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, HMOs 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.

The 2012 net patient service revenue increased approximately \$300,000 due to removal of previously estimated amounts that are no longer necessary as a result of final settlements.

Note 3: Deposits, Investments and Investment Income

Deposits

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

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

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2012

Investments

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest in corporate bonds and equity securities.

At December 31, 2012, the Hospital had the following investments and maturities:

Type	December 31, 2012				
	Fair Value	Maturities in Years			
		Less Than 1	1-5	6-10	More Than 10
Fixed income mutual funds	\$ 4,251,149	\$ 4,251,149	\$ -	\$ -	\$ -
U.S. Governmental securities	1,262,939	1,262,939	-	-	-
	<u>\$ 5,514,088</u>	<u>\$ 5,514,088</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Interest Rate Risk - As a means of limiting its exposure to fair value losses arising from rising interest rates, the Hospital's investment policy limits investments to certificates of deposit and certain bond and mutual funds. No more than 50% of the total portfolio should be invested in bond and mutual funds. Generally, the maturity date on all investments shall not exceed two years.

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in certain bond and mutual funds to the American Hospital Association's Investment Fund and other portfolios with AAA or government backed ratings. At December 31, 2012, the Hospital's investments in bond funds were rated by Standard & Poor's and or Moody's Investors Service as follows:

Type	Fair Value	AAA	AA	A	BBB
Fixed income mutual funds	\$ 4,251,149	\$ 2,739,468	\$ 566,300	\$ 895,066	\$ 50,315
U.S. Governmental securities	1,262,939	1,246,405	16,534	-	-
	<u>\$ 5,514,088</u>	<u>\$ 3,985,873</u>	<u>\$ 582,834</u>	<u>\$ 895,066</u>	<u>\$ 50,315</u>

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

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

Summary of Carrying Values

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

	2012
Carrying value:	
Deposits	\$ 9,910,987
Investments	5,514,088
	\$ 15,425,075
 Included in the following balance sheet captions:	
Cash	\$ 3,101,196
Noncurrent cash and investments - funded depreciation	12,323,879
	\$ 15,425,075

Investment Income

Investment income for the year ended December 31 consisted of:

	2012
Interest and dividend income	\$ 110,093
Net increase in fair value of investments	20,634
	\$ 130,727

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Note 4: Patient Accounts Receivable

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

	2012
Medicare	\$ 580,353
Medicaid	41,789
Other third-party payers	1,725,506
Patients	2,014,671
	4,362,319
Less allowance for uncollectible accounts	1,813,600
	\$ 2,548,719

Note 5: Capital Assets

Capital assets activity for the year ended December 31 was:

	2012				Ending Balance
	Beginning Balance	Additions	Disposals	Transfers	
Hospital					
Land	\$ 1,042,227	\$ -	\$ -	\$ -	\$ 1,042,227
Buildings and leasehold improvements	16,871,566	18,641	-	-	16,890,207
Equipment	13,484,820	776,781	(77,691)	272,672	14,456,582
Construction in progress	308,013	-	-	(272,672)	35,341
	31,706,626	795,422	(77,691)	-	32,424,357
Less accumulated depreciation:					
Buildings and leasehold improvements	13,613,518	1,492,158	(67,138)	-	15,038,538
Equipment	3,189,546	225,421	-	-	3,414,967
	16,803,064	1,717,579	(67,138)	-	18,453,505
Total Hospital capital assets, net	\$ 14,903,562	\$ (922,157)	\$ (10,553)	\$ -	\$ 13,970,852

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Note 6: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claims costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 7: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of \$1,000,000, and an individual policy maximum of \$55,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims, and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during 2012 is summarized as follows:

	2012
Balance, beginning of year	\$ 232,092
Current year claims incurred and changes in estimates for claims incurred in prior years	1,480,738
Claims and expenses paid	(1,571,640)
Balance, end of year	\$ 141,190

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Note 8: Long-Term Obligations

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

	2012				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Indiana Health Facility Financing Authority Revenue Bonds	\$ 990,000	\$ -	\$ (990,000)	\$ -	\$ -
Total long-term debt	\$ 990,000	\$ -	\$ (990,000)	\$ -	\$ -

Indiana Health Facility Financing Authority Revenue Bonds

The Indiana Health Facility Financing Authority Revenue Bonds (Series 1998) consisted of bonds in the original amount of \$12,000,000 dated May 1, 1998, which bore interest at various amounts ranging from 0.24% to 0.82%. The Series 1998 bonds were payable in annual installments through May 1, 2019. During 2012, principal balances outstanding and interest on the bonds were paid in full.

Note 9: Pension Plan

The Hospital contributes to a defined-contribution pension plan covering substantially all employees following one year of service. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by a board of trustees appointed by the Hospital Board. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Plan members may contribute up to \$17,000 of their annual covered salary. The Hospital is required to match one-half of the employee contribution up to 5% of employee's compensation. In addition, the Hospital contributes 2% of the annual covered payroll for all eligible active participants. Hospital expense related to employer contributions to the plan was \$294,080 for 2012. The Hospital had accrued benefits payable to the plan of \$161,889 at December 31, 2012.

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Note 10: Risks and Uncertainties

Current Economic Conditions

The current economic environment presents hospitals with unprecedented circumstances and challenges, which, in some cases, have resulted in large declines in the fair value of investments and other assets, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values and allowances for accounts receivable that could negatively impact the Hospital's ability to maintain sufficient liquidity.

Note 11: Contingencies

Litigation

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

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Note 12: Restatement of Prior Year's Financial Statements

The Hospital's beginning net position has been restated and decreased for an error of \$1,166,226, applicable to prior years. The Fitness Center's beginning net assets have been restated and increased for an error of \$1,166,226, applicable to prior years. This error was related to the transfer of assets between the two entities, which had been incorrectly recorded as a receivable and offsetting payable, within the Hospital and Fitness Center, respectively. During 2012, the Hospital and the Fitness Center retroactively changed their accounting method to remove this receivable and offsetting payable.