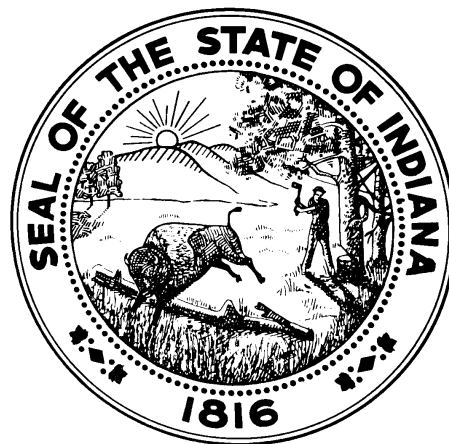


STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

AUDIT REPORT
OF

SCOTT MEMORIAL HOSPITAL
A COMPONENT UNIT OF
SCOTT COUNTY, INDIANA

January 1, 2007 to December 31, 2007



FILED
09/30/2008

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HOSPITAL OFFICIALS

| <u>Office</u> | <u>Official</u> | <u>Term</u> |
|---|--------------------------------|--|
| President and Chief Executive Officer | Clifford D. Nay | 01-01-07 to 12-31-08 |
| Chief Financial Officer/ Treasurer | Angela G. Doan | 01-01-07 to 12-31-08 |
| Chairman of the Hospital Board | Ivan R. Wells Donna Faris | 01-01-07 to 12-31-07 01-01-08 to 12-31-08 |
| President of the Board of County Commissioners | Robert Tobias Larry Blevins | 01-01-07 to 12-31-07 01-01-08 to 12-31-08 |



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of Scott Memorial Hospital (Hospital), as of and for the year ended December 31, 2007, 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 did not audit the financial statements of the Jewish Hospital & St. Mary's HealthCare Network Regional Service Center, LLC, an affiliated company. Those financial statements were audited by other auditors whose report has been furnished to us. Our opinion, insofar, as it relates to the investment in affiliated companies (other assets) in the amount of \$170,148, is based solely on the report of the other auditors.

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, based on our audit and report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Hospital as of December 31, 2007, 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 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

August 21, 2008

SCOTT MEMORIAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS

This section of Scott Memorial Hospital's (Hospital) annual financial statements presents background information and management's discussion and analysis (MD&A) of the Hospital's financial performance during this fiscal year ended December 31, 2007. This MD&A should be read together with the financial statements included in this report. While there are comparisons made in this report to December 31, 2006 we realize that they are not presented in the audited financial statements but have listed them in this report for comparative discussion. Figures shown are rounded to the thousands.

OPERATING RESULTS AND FINANCIAL PERFORMANCE

During 2007, the Hospital derived substantially all of its revenue from patient services and other related activities. The Hospital's revenues depend upon inpatient occupancy levels, related ancillary services, and outpatient procedures as ordered by physicians. The Hospital's gross charges typically do not reflect what is actually paid. The Hospital has entered into agreements with third-party payers, including government programs and managed care health plans, under which payments for healthcare services provided to patients are based upon predetermined rates according to the patient's diagnosis or on a discount from gross charges. Provisions have been made in the financial statements for contractual adjustments, which represent the difference between the standard charges for services and the actual or anticipated payment.

The Hospital receives a significant portion of its revenues from government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. In 2007, inpatient revenues from the Medicare and Medicaid programs increased to 77.3% of total gross inpatient revenues up from 74.8% in 2006. Outpatient revenues from the Medicare and Medicaid programs showed a decrease from 2006 to 2007, going from 49.2% to 48.1%.

The table below presents the percentages of gross revenues for patient services, by payer, for the years ended December 31, 2007 and 2006, respectively:

| | 2007 | | | 2006 | | |
|------------|-----------|------------|----------|-----------|------------|----------|
| | Inpatient | Outpatient | Combined | Inpatient | Outpatient | Combined |
| Medicare | 58.0% | 29.5% | 37.5% | 55.1% | 29.5% | 38.8% |
| Medicaid | 17.6% | 18.6% | 18.3% | 24.5% | 18.1% | 17.3% |
| Blue Cross | 7.8% | 19.0% | 15.9% | 4.6% | 17.0% | 15.0% |
| Other | 10.9% | 23.5% | 20.00% | 11.3% | 25.7% | 21.5% |
| Self Pay | 5.7% | 9.4% | 8.3% | 4.5% | 9.7% | 7.4% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

FINANCIAL STATEMENTS

The financial statements of the Hospital present information about the Hospital using financial reporting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information. The Balance Sheet includes all of the Hospital's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to Hospital creditors (liabilities). All of the current year's revenues and expenses are accounted for in the Statement of Revenue and Expenses and Changes in Net Assets. These statements measures the financial results of the Hospital's operations and presents revenues earned and expenses incurred. The final statement is the Statement of Cash Flows. The primary purpose of the statement is to provide information about the Hospital's cash flow from operating activities, capital and related financing activities and investing activities, and provides information on the sources and uses of cash during the year.

FINANCIAL ANALYSIS

The Balance Sheet and the Statement of Revenues and Expenses and Changes in Net Assets report information about the Hospital's activities. These three statements report the net assets of the Hospital and its changes. Increases or decreases in the Hospital's net assets are one indicator of whether it's financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, population growth (including uninsured and medically indigent individuals and families) and new or changed government legislation need to also be considered.

A summary of the Hospital's Combined Balance Sheets as of December 31, 2007 and 2006 is presented below (in thousands):

| | 2007 | 2006 | \$ Change | % Change |
|--------------------------------------|-----------------|-----------------|----------------|------------|
| Assets: | | | | |
| Cash and equivalents | \$ 3,967 | \$ 4,703 | \$(736) | (16%) |
| Other assets | 2,606 | 2,511 | 95 | 4% |
| Net property and equipment | 16,894 | 12,351 | 4,543 | 37% |
| Accounts Receivable | 5,535 | 4,312 | 1,223 | 28% |
| Short Term Investments | 5,088 | 4,829 | 259 | 5% |
| Total Assets | \$34,090 | \$28,707 | \$5,384 | 19% |
| Liabilities and Fund Balance: | | | | |
| Current and other liabilities | \$4,542 | \$1,100 | \$3,442 | 313% |
| Long-term obligations | 0 | 0 | 0 | 0 |
| Total liabilities | 4,542 | 1,100 | 3,442 | 313% |

| | | | | |
|---|-----------------|-----------------|----------------|------------|
| Total Unrestricted Net Assets | 29,548 | 27,607 | 1,941 | 7% |
| Total Liabilities & Fund Balance | \$34,090 | \$28,707 | \$5,383 | 19% |

Notes on the Balance Sheet

- The Hospital's fund balance increased by \$2 million, derived from operating income.
- The Hospital investment policy allows it to invest in mutual funds. Short & long term investments increased 5% due to this change.
- Cash decreased 16% due to increase in revenue of 5% and increase in AR days and initial payments on surgery expansion.
- Receivables, net increased 28% due to increase in revenue of 5% and in some billing issues that caused a delay in payment. Radiology billing could not begin until 2008 and there were about 15 days related to radiology charges in AR.
- Estimated third party settlements increased 13%, this was due to our change in CAH and the receiving 100% of Medicare allowable bad debt. CAH means that we are a Critical Access Hospital and the reimbursement is different then for a general acute care facility.
- Capital Assets, increased 37%. This was caused due to purchase of CT scanner and 3 Million related to the surgery expansion.
- Accounts payable and accrued expenses increased 746% in 2007. Vendor accruals increased by \$17,000 and general accruals decreased by \$2,794. This increase came from Surgery expansion invoices and CT purchase that was not installed until February 2008. The management contract increased by \$189,000 due to the change that was made in 2006 to recalculate the management fee without investment income.
- Current liabilities increased 313%. This change occurred in accrued wages and accrued vacation of \$123,000. The CT scanner was received in December, but we did not have to pay for it until February. The retainage for the surgery project and 3 months of Wehr invoices were not received but accrued.

CAPITAL ASSETS

- During the year, the Hospital made the following significant capital acquisitions and improvements:
 - The Hospital invested \$1,080,000 on a new 64-slice CT Scanner.
 - The Hospital invested \$3,456,000 in the start of the surgery expansion.
 - The Hospital invested \$456,000 in a PACS/RIS system for radiology.
 - The Hospital invested \$156,000 in a 4D ultrasound unit.
 - The Hospital invested \$542,000 in other areas of the hospital.

A summary of the Hospital's capital asset balances as of December 31, 2007 and 2006 is presented below (in thousands):

| | As of 12/31/2006 | Additions | Disposals/ Retirements | As of 12/31/2007 |
|--------------------------|-----------------------------|------------------|-----------------------------------|-----------------------------|
| Land and improvements | \$ 772 | \$ 7 | \$ 0 | \$ 779 |
| Buildings | 12,388 | 191 | 49 | 12,530 |
| Equipment | 10,320 | 2,033 | 90 | 12,263 |
| Construction in progress | 149 | 3,917 | 163 | 3,903 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total capital assets | 23,629 | 6,148 | 302 | 29,475 |
| Less accumulated | | | | |
| Depreciation | (11,278) | 1,424 | 121 | (12,581) |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Capital assets – net | \$12,351 | \$ 4,724 | \$ 181 | \$16,894 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |

A summary of the Hospital's Statements of Revenue and Expenses and Changes in Fund Balances for the years ended December 31, 2007 and 2006 is presented below (in thousands):

| | 2007 | 2006 | \$ Change | % Change |
|---------------------------------|-------------|-------------|----------------------|-----------------|
| Revenues: | | | | |
| Net patient service revenue | \$22,226 | \$19,430 | \$2,796 | 14% |
| Other | 422 | 386 | 36 | 9% |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total Revenues | \$22,648 | \$19,816 | \$2,832 | 14% |
| Operating Expenses: | | | | |
| Salaries and benefits | \$12,504 | \$10,003 | \$2,501 | 25% |
| Medical Professional Fees | 157 | 139 | 18 | 13% |
| Purchased Services | 2,634 | 2,385 | 249 | 10% |
| Supplies | 2,786 | 2,457 | 329 | 13% |
| Other | 1,260 | 1,141 | 119 | 10% |
| Management Fees | 432 | 263 | 169 | 64% |
| Depreciation | 1,425 | 1,373 | 52 | 4% |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total Operating Expenses | \$21,198 | \$17,761 | \$3,437 | 19% |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |

| | | | | |
|--|----------------|----------------|------------------|--------------|
| Operating Income | 1,450 | 2,055 | (605) | (29%) |
| Investment Income | 425 | 797 | (372) | (47%) |
| Non-capital grants and contributions | 0 | 148 | (148) | (100%) |
| Other non-operating income | (4) | (6) | (2) | (33%) |
| Gain (loss) on invest in affiliated companies & gain/loss on equip | (20) | 32 | (52) | (163%) |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total non operating revenues | 401 | 971 | (570) | (59%) |
| Excess (deficiency) before capital grants and contributions | 1,851 | 3,024 | (1,173) | (39%) |
| Capital grants and contributions | 90 | 0 | 90 | 0 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Increase (decrease) in net assets | <u>\$1,941</u> | <u>\$3,024</u> | <u>(\$1,083)</u> | <u>(36%)</u> |

Notes on the Hospital's Combined Statements of Operations and Changes in Net Assets:

- The Hospital's fund balance increased by \$1.9 million, derived from operating income.
- Personnel expense increased by 25%, this was due mainly to the adding of the orthopedic office which included 3 FTE's.
- Supplies increased 13% due to volume increases.
- Purchased services increased 10% due to volume.
- Professional services increased 13% due to some legal issues.
- Other increased 10% due mainly to liability insurance.
- Management fees increased \$269,000 from 2006 to 2007. These fees are based on the hospital's net assets before contributions, however, there was a contact correction made in the calculation to exclude investment income from this calculation in 2006. There was a contract period revision back to the start of the contract in 1991. This is the main reason for the increase. The fee would have decreased in 2007 based on net income from operations before DSH was higher in 07 then in 06.
- We implemented an investment policy, which allowed us to invest more aggressively which contributed to the significant decrease in investment income due to market conditions.
- The hospital booked the total loss for the Healthstaff Solutions for all years that it was invested.
- No significant grants or contributions were received in 2007.

Future Events

- The hospital will be moving forward with the construction and renovation of new surgery suite. We anticipate moving into the first phase in September 08, with the ending to be at year-end. The total construction project was budgeted at \$7.6 million and we are currently expecting to pay for the project without borrowing any funds.

SCOTT MEMORIAL HOSPITAL
STATEMENT OF NET ASSETS
December 31, 2007

Assets

| | |
|--|----------------------|
| Current assets: | |
| Cash and cash equivalents | \$ 3,967,273 |
| Short-term investments | 5,088,348 |
| Patient accounts receivable, net of estimated uncollectibles of \$8,422,585 | 5,535,259 |
| Estimated third-party settlements | 563,836 |
| Supplies and other current assets | 1,898,397 |
| Capital assets: | |
| Land and construction in progress | 4,179,693 |
| Depreciable capital assets, net of accumulated depreciation | 12,714,504 |
| Other assets | <u>143,037</u> |
| Total assets | <u>\$ 34,090,347</u> |

Liabilities and Net Assets

| | |
|---|----------------------|
| Current liabilities: | |
| Accounts payable and accrued expenses | \$ 3,763,932 |
| Other current liabilities | <u>778,124</u> |
| Total liabilities | <u>4,542,056</u> |
| Net assets: | |
| Invested in capital assets, net of related debt | 15,814,097 |
| Unrestricted | <u>13,734,194</u> |
| Total net assets | <u>29,548,291</u> |
| Total liabilities and net assets | <u>\$ 34,090,347</u> |

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

SCOTT MEMORIAL HOSPITAL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year Ended December 31, 2007

| | |
|---|----------------------|
| Operating revenues: | |
| Net patient service revenue (net of provision for bad debt) | \$ 22,225,920 |
| Other | <u>422,408</u> |
| Total operating revenues | <u>22,648,328</u> |
| Operating expenses: | |
| Personnel | 12,504,509 |
| Supplies | 2,785,966 |
| Purchased services | 2,634,242 |
| Professional fee | 157,239 |
| Other | 1,259,600 |
| Depreciation | 1,424,870 |
| Management fee | <u>432,164</u> |
| Total operating expenses | <u>21,198,590</u> |
| Operating income | <u>1,449,738</u> |
| Nonoperating revenues (expenses): | |
| Investment income | 425,384 |
| Loss on sale of equipment | (4,293) |
| Loss on investment in affiliated companies | <u>(20,123)</u> |
| Total nonoperating revenues (expenses) | <u>400,968</u> |
| Excess of revenues over expenses before capital grants and contributions | 1,850,706 |
| Capital grants and contributions | <u>90,428</u> |
| Increase in net assets | 1,941,134 |
| Net assets beginning of the year | <u>27,607,157</u> |
| Net assets end of the year | <u>\$ 29,548,291</u> |

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

SCOTT MEMORIAL HOSPITAL
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS
Year Ended December 31, 2007

| | |
|---|---------------------|
| Cash flows from operating activities: | |
| Receipts from and on behalf of patients | \$ 21,002,949 |
| Payments to suppliers and contractors | (4,013,413) |
| Payments to employees | (12,375,774) |
| Other receipts and payments, net | <u>358,787</u> |
| Net cash provided by operating activities | <u>4,972,549</u> |
| Cash flows from capital and related financing activities: | |
| Capital grants and contributions | 90,428 |
| Proceeds from sale of capital assets | 13,432 |
| Purchase of capital assets | <u>(5,986,235)</u> |
| Net cash used by capital and related financing activities | <u>(5,882,375)</u> |
| Cash flows from investing activities: | |
| Interest and dividends on investments | 166,629 |
| Distribution from Investment in affiliated company | <u>7,182</u> |
| Net cash provided by investing activities | <u>173,811</u> |
| Net decrease in cash and cash equivalents | (736,015) |
| Cash and cash equivalents at beginning of year | <u>4,703,288</u> |
| Cash and cash equivalents at end of year | <u>\$ 3,967,273</u> |
| Reconciliation of cash and cash equivalents to the Statement of Net Assets: | |
| Cash and cash equivalents in current assets | \$ 3,967,273 |
| Restricted cash and cash equivalents | <u>-</u> |
| Total cash and cash equivalents | <u>\$ 3,967,273</u> |
| Reconciliation of operating income to net cash provided by operating activities: | |
| Operating income | |
| Adjustments to reconcile operating income to net cash flows used in operating activities: | \$ 1,449,738 |
| Depreciation and amortization | |
| Provision for bad debts | 1,424,870 |
| Increase in current assets: | 5,622,667 |
| Patient accounts receivable | |
| Supplies and other current assets | (6,845,638) |
| Estimated third-party payor settlements | (57,434) |
| Increase in current liabilities: | (63,621) |
| Accounts payable and accrued expenses | |
| Other current liabilities | 3,318,810 |
| | <u>123,157</u> |
| Net cash provided in operating activities | <u>\$ 4,972,549</u> |

Noncash investing, capital, and financing activities:

The Hospital held investments at December 31, 2007, with a fair value of \$5,088,348. During 2007, the net increase in the fair value of these investments was \$258,755.

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

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

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

The Board of County Commissioners of Scott County appoints the Governing Board of the Hospital and a financial benefit/burden relationship exists between the County and the Hospital. For these reasons, the Hospital is considered a component unit of Scott County.

The accompanying financial statements present the activities of the Hospital (primary government). There are no significant component units which require inclusion.

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.

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.

Open-end mutual funds are reported at fair value.

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

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

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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:

| | <u>Capitalization Threshold</u> | <u>Depreciation Method</u> | <u>Estimated Useful Life</u> |
|----------------------------|-------------------------------------|--------------------------------|----------------------------------|
| Land improvements | \$ 1,000 | Straight-line | 5 to 25 years |
| Buildings and improvements | 1,000 | Straight-line | 5 to 50 years |
| Equipment | 1,000 | Straight-line | 2 to 25 years |

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

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. There was no interest expense incurred by the Hospital during the current year.

4. Net Assets

Net assets of the Hospital are classified in two components.

Net assets invested in capital assets consist of capital assets net of accumulated depreciation.

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

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

D. Grants and Contributions

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

E. Restricted Resources

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

F. Operating Revenues and Expenses

The Hospital's Statement of Revenues, Expenses and Changes in Net 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

1. Sick Leave

Hospital employees earn sick leave at the rate of 12 days per year. Unused sick leave may be accumulated to a maximum of 54 to 60 days depending upon job classification. Accumulated sick leave is not paid to employees.

2. Vacation Leave

Hospital employees earn vacation leave at rates from 10 days to 20 days per year based upon the number of years of service. Vacation leave may be carried over from one year to the next; however, the amount carried over cannot exceed the employee's annual accrual amount.

3. Personal Leave

Hospital employees earn personal leave at the rate of 1 to 3 days per year. Personal leave is not cumulative and must be taken within 6 months after being accrued.

Vacation leave is accrued when incurred and reported as a liability.

No liability is reported for sick and personal leave.

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

II. Detailed Notes

A. Deposits and Investments

1. Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 16-22-3-15 requires only that money in the hospital funds be deposited in the manner determined by the governing board. The Hospital does not have a formal policy regarding custodial credit risk for deposits. The balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

2. Investments

Authorization for investment activity is stated in Indiana Code 16-22-3-20. As of December 31, 2007, the Hospital had mutual funds with a market value of \$5,088,348.

Investment Policies

Indiana Code 16-22-3-20 authorizes the Hospital to invest in: (1) any interest bearing account that is authorized to be set up and offered by a financial institution or brokerage firm registered and authorized to do business in Indiana; (2) repurchase or resale agreements involving the purchase and guaranteed resale of any interest bearing obligations issued or fully insured or guaranteed by the United States or any United States government agency in which type of agreement the amount of money must be fully collateralized by interest bearing obligations as determined by the current market value computed on the day the agreement is effective; (3) mutual funds offered by a financial institution or brokerage firm registered and authorized to do business in Indiana; (4) securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency; or (5) pooled fund investments for participating hospitals offered, managed, and administered by a financial institution or brokerage firm registered or authorized to do business in Indiana.

B. Accounts Receivable and Payable

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

Patient Accounts Receivable

| | |
|---|----------------------------|
| Receivable from patients and their insurance carriers | \$ 8,368,745 |
| Receivable from Medicare | 3,537,037 |
| Receivable from Medicaid | <u>2,052,062</u> |
| Total patient accounts receivable | 13,957,844 |
| Less allowance for uncollectible amounts | <u>8,422,585</u> |
| Patient accounts receivable, net | <u><u>\$ 5,535,259</u></u> |

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Accounts Payable and Accrued Expenses

| | | |
|---|--------|-----------------------------|
| Payable to employees (including payroll taxes) | \$ | 778,770 |
| Payable to suppliers | | 3,758,354 |
| Other | | <u>4,932</u> |
| Total accounts payable and accrued expenses | \$ | <u><u>4,542,056</u></u> |

C. Capital Asset

Capital asset activity for the year ended December 31, 2007, was as follows:

| | <u>Beginning Balance</u> | <u>Increases</u> | <u>Decreases</u> | <u>Ending Balance</u> |
|---|---------------------------------|--------------------------------|------------------------------|---------------------------------|
| Capital assets, not being depreciated: | | | | |
| Land | \$ 276,233 | \$ - | \$ - | \$ 276,233 |
| Construction in progress | <u>148,968</u> | <u>3,917,945</u> | <u>163,453</u> | <u>3,903,460</u> |
| Total capital assets, not being depreciated | <u>425,201</u> | <u>3,917,945</u> | <u>163,453</u> | <u>4,179,693</u> |
| Capital assets, being depreciated: | | | | |
| Buildings | 12,388,225 | 191,124 | 49,085 | 12,530,264 |
| Improvements other than buildings | 495,562 | 7,000 | - | 502,562 |
| Fixed equipment | 2,031,796 | 20,184 | 80,744 | 1,971,236 |
| Major movable equipment | <u>8,288,088</u> | <u>2,013,435</u> | <u>8,934</u> | <u>10,292,589</u> |
| Totals | <u>23,203,671</u> | <u>2,231,743</u> | <u>138,763</u> | <u>25,296,651</u> |
| Less accumulated depreciation for: | | | | |
| Buildings | 3,945,892 | 543,633 | 31,360 | 4,458,165 |
| Improvements other than buildings | 319,934 | 32,624 | - | 352,558 |
| Fixed equipment | 1,686,873 | 59,326 | 80,744 | 1,665,455 |
| Major movable equipment | <u>5,325,616</u> | <u>789,287</u> | <u>8,934</u> | <u>6,105,969</u> |
| Totals | <u>11,278,315</u> | <u>1,424,870</u> | <u>121,038</u> | <u>12,582,147</u> |
| Total capital assets, being depreciated, net | <u>11,925,356</u> | <u>806,873</u> | <u>17,725</u> | <u>12,714,504</u> |
| Total capital assets, net | <u><u>\$ 12,350,557</u></u> | <u><u>\$ 4,724,818</u></u> | <u><u>\$ 181,178</u></u> | <u><u>\$ 16,894,197</u></u> |

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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, 2007</u> | <u>Required Future Funding</u> |
|----------------|---|--|--|
| Med 3/ICU | \$ 108,168 | \$ 106,680 | \$ 1,488 |
| Avery Office | 4,876 | 4,876 | - |
| Radiology | 1,206,302 | 18,510 | 1,187,792 |
| Surgery | <u>7,783,585</u> | <u>3,773,394</u> | <u>4,010,191</u> |
| Totals | <u>\$ 9,102,931</u> | <u>\$ 3,903,460</u> | <u>\$ 5,199,471</u> |

E. Lease

Operating Lease

The Hospital has entered into an operating lease having initial or remaining noncancelable terms exceeding one year for video endoscopy equipment. Annual rental expenditures for this lease were \$53,926. The following is a schedule by years of future minimum rental payments as of year end:

| | |
|-------|-------------------|
| 2008 | \$ 53,926 |
| 2009 | <u>53,926</u> |
| Total | <u>\$ 107,852</u> |

F. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were \$72,597 for 2007.

IV. Other Information

A. Risk Management

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

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

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

B. Management Agreement and Related Party Transactions

In 1991, the Hospital entered into an agreement with MedGroup Management, Inc. (MedGroup), an affiliate of Jewish Hospital & St. Mary's HealthCare, Inc., whereby MedGroup would supervise, manage and operate the Hospital. According to the agreement, MedGroup will provide the Chief Executive Officer, who will be appointed by the Hospital's Board of Directors, and the Chief Financial Officer.

The management fee reported on the Statement of Revenue, Expense, and Changes in Net Assets in the amount of \$432,164 represents the portion of the management contract fee that is based on the Hospital's operating income. The total expenses related to the management contract, including the fee based on operating income, totaled \$831,957 for the year 2007. In addition, expenses in the amount of \$1,831,953 were incurred during 2007 for services performed by Jewish Hospital & St. Mary's HealthCare, Inc., and its related entities. The amount of \$322,666 was due to MedGroup Management and its affiliates as of December 31, 2007.

C. Contingent Liabilities

Litigation

The Hospital is involved in litigation 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.

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.

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.

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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. Investment in Affiliated Companies

Regional Service Center

In 1999, the Hospital entered into an agreement with seven related hospitals to establish and operate a purchasing and supply distribution center. In accordance with this agreement, the Hospital invested \$103,183 for 1.6% equity interest in the distribution center. The investment was made in the years 1999 and 2000. The distribution center began operations in 1999. During 2004, the agreement was amended to allow for annual ownership adjustments based on the aggregate purchases of all members during the fiscal year most recently ended. Accordingly, at December 31, 2007, Scott Memorial Hospital's equity interest was 1.2%. The investment is recorded on the equity method. The Hospital's investment in affiliated companies is included in the Other Assets category of the Statement of Net Assets.

Summarized financial information as of December 31, 2007, and for the year then ended from the audited financial statements of the Affiliated Company follows:

| | |
|------------------------|---------------|
| Current assets | \$ 21,265,196 |
| Noncurrent assets | 495,563 |
| Current liabilities | 7,917,054 |
| Noncurrent liabilities | - |
| Stockholders' equity | 13,843,705 |
| Revenue | 112,596,570 |
| Net income | 1,148,497 |

In 2007, services and supplies in the amount of \$987,533 were provided by the distribution center to the Hospital. At December 31, 2007, \$58,357 was reported in accounts payable as owed to the service center. During 2007, the Hospital received distributions from the service center in the amount of \$7,182.

Health Care Staffing Agency

In 2002, the Hospital entered into an agreement with two related hospitals to establish and operate a health care staffing agency and cost share support services. In accordance with this agreement, the Hospital invested \$8,869 for 7% equity interest in the health care staffing agency. The investment was made in the year 2002. The health care staffing agency began operation in 2002. The investment was originally recorded on the cost method; however, in 2007 the hospital began recording the investment on the equity method. The Hospital's investment in affiliated companies is included in the Other Assets category of the Statement of Net Assets.

Summarized financial information as of December 31, 2007, and for the year then ended from the unaudited financial statements of the Affiliated Company follows:

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

| | | |
|----------------------|----|-----------|
| Current assets | \$ | 88,000 |
| Noncurrent assets | | -- |
| Current liabilities | | 466,000 |
| Stockholders' equity | | (378,000) |
| Revenue | | 817,000 |
| Net loss | | (343,000) |

In 2007, services in the amount of \$92,600 were provided by the health care staffing agency to the Hospital. At December 31, 2007, \$5,902 was recognized in accounts payable as amounts owed by the Hospital to the Health Care Staffing Agency.

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 2007, net patient service revenues in the accompanying statements of operations were decreased by \$247,980, to reflect changes in the estimated settlements for certain prior years.

G. Pension Plan

Defined Contribution Pension Plan

Plan Description

The Hospital has a defined contribution pension plan administered by American United Life Insurance Company (AUL) 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 does not issue a publicly available financial report that includes financial statements and required supplementary information of the plan.

Funding Policy and Annual Pension Cost

The contribution requirements of plan members are established by the written agreement between the Hospital Board of Trustees and the Plan Administrator. Plan members may, but are not required to, contribute to the fund. The Hospital is required to contribute 4% of each eligible individual's annual covered payroll. Statements of employer and employee contributions to the plan are sent to individual plan members. The Hospital does not receive a statement.

SCOTT MEMORIAL HOSPITAL
AUDIT RESULT AND COMMENT

CERTIFIED REPORT NOT FILED

The Hospital did not file a certified report of compensation of officers and employees (Form 100-R or its equivalent) with the State Board of Accounts for the year 2007, in a timely manner.

Indiana Code 5-11-13-1 states in part: ". . . every executive officer by whatever title designated, who is in charge of . . . any other state, county, or city institution, . . . shall during the month of January of each year prepare, make, and sign a written or printed certified report, correctly and completely showing the names and addresses of each and all officers, employees, and agents . . . and the respective duties and compensation of each, and shall forthwith file said report in the office of the state examiner of the state board of accounts . . ."

SCOTT MEMORIAL HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on August 21, 2008, with Albert Thormyer, Board Member; Clifford D. Nay, President/Executive Director; Angela G. Doan, Chief Financial Officer/Treasurer; Vice-Chairman of the Hospital Board. The officials concurred with our audit finding.