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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, 2009 to December 31, 2009



FILED
05/24/2010

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HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
President/ Chief Executive Officer	Clifford D. Nay	01-01-09 to 12-31-10
Treasurer/ Chief Financial Officer	Angela G. Doan	01-01-09 to 12-31-10
Chairman of the Hospital Board	Albert L. Thormyer Randy Hancock	01-01-09 to 12-31-09 01-01-10 to 12-31-10
President of the Board of County Commissioners	Mark Hayes Robert Tobias	01-01-09 to 12-31-09 01-01-10 to 12-31-10



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2769

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of the business-type activities of the Scott Memorial 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 presents 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 Hospital has not presented Management's Discussion and Analysis, that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

STATE BOARD OF ACCOUNTS

April 15, 2010

SCOTT MEMORIAL HOSPITAL
STATEMENT OF NET ASSETS
December 31, 2009
(In Thousands)

Assets

Current assets:	
Cash and cash equivalents	\$ 654
Investment	2,410
Patient accounts receivable, less estimated doubtful accounts and allowances \$7,167	5,663
Other	376
Estimated third-party settlements	249
Inventories	479
Prepaid expenses	<u>479</u>
 Total current assets	 <u>10,310</u>
Long-term assets:	
Property and equipment	36,186
Construction in progress	5
Less accumulated depreciation	<u>(15,227)</u>
 Total long-term assets	 <u>20,964</u>
 Total assets	 <u>\$ 31,274</u>

Liabilities and Net Assets

Current liabilities:	
Accounts payable	\$ 569
Accrued expenses	<u>586</u>
 Total liabilities	 <u>1,155</u>
Net assets:	
Unrestricted	<u>30,119</u>
 Total liabilities and net assets	 <u>\$ 31,274</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, 2009
(In Thousands)

Net patient service revenues (net of provision for bad debt)	\$ 21,190
Other operating revenues	<u>551</u>
 Total operating revenues	 <u>21,741</u>
 Operating expenses:	
Personnel	12,953
Supplies	2,635
Purchased services	3,371
Professional fees	317
Other	1,808
Depreciation	<u>2,082</u>
 Total operating expenses	 <u>23,166</u>
 Loss from operations	 (1,425)
 Nonoperating revenues (expenses):	
Interest expense	(110)
Gain on investment in affiliated companies	14
Investment income	<u>815</u>
 Deficiency of revenues under expenses before contributions	 (706)
 Contributions	 <u>100</u>
 Decrease in net assets	 (606)
 Net assets beginning of the year	 <u>30,725</u>
 Net assets end of the year	 <u><u>\$ 30,119</u></u>

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

SCOTT MEMORIAL HOSPITAL
STATEMENT OF CASH FLOWS
Year Ended December 31, 2009
(In Thousands)

Cash flows from operating activities:	
Receipts from and on behalf of patients	\$ 22,239
Payments to suppliers and contractors	(8,971)
Payments to employees	(13,004)
Other receipts and payments, net	<u>1,659</u>
Net cash provided by operating activities	<u>1,923</u>
Cash flows from noncapital financing activities:	
Noncapital grants and contributions	<u>100</u>
Cash flows from capital and related financing activities:	
Purchase of capital assets	(2,612)
Proceeds from loans	2,315
Principal paid on loans	(3,000)
Interest paid on loans	<u>(110)</u>
Net cash used by capital and related financing activities	<u>(3,407)</u>
Cash flows from investing activities:	
Investment fees	(6)
Increase in investment in affiliated company	31
Sales of investments	<u>1,950</u>
Net cash provided by investing activities	<u>1,975</u>
Net increase in cash and cash equivalents	591
Cash and cash equivalents at beginning of year	<u>63</u>
Cash and cash equivalents at end of year	<u>\$ 654</u>
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents in current assets	\$ 654
Restricted cash and cash equivalents	<u>-</u>
Total cash and cash equivalents	<u>\$ 654</u>
Reconciliation of operating income to net cash used by operating activities:	
Operating loss	\$ (1,425)
Adjustments to reconcile operating income to net cash flows used in operating activities:	
Depreciation	2,082
Provision for bad debts	8,174
(Increase) decrease in current assets:	
Patient accounts receivable	(7,125)
Supplies and other current assets	448
Estimated third-party payor settlements	1,108
Decrease in current liabilities:	
Accounts payable and accrued expenses	<u>(1,339)</u>
Net cash provided in operating activities	<u>\$ 1,923</u>

Noncash investing activities:

On January 1, 2009, the Hospital held investments with a fair value of \$3,539,000. On December 31, 2009, the Hospital held investments with a fair value of \$2,410,000. During 2009, \$1,950,000 in investments were sold. The net increase in the fair value of investments over the period was \$821,000.

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. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the enterprise fund statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their enterprise funds, subject to this same limitation. The Hospital has elected to apply subsequent private-sector guidance.

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.

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

Open-end mutual funds are reported at fair value.

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

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

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as 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 accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Capital Assets

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

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

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

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

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

4. Net Assets

Net assets of the Hospital are classified in two components.

Net assets invested in capital assets net of accumulated depreciation.

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

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. New Patient Service Revenue

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

H. Charity Care

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

I. Supplies

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

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

J. Compensated Absences

1. Paid Time-Off

The Paid Time-Off (PTO) plan includes an accrual of hours to be used for vacation, holidays, personal days, and short-term personal illnesses of two days or less. Hospital employees earn PTO hours at the rate of 144 to 240 hours per year based on status and years of service. The maximum accrual of PTO is limited to 1 ½ times an employee's current accrual rate. Active employees may request cash payments for unused PTO which is paid at a rate of 75% of the employee's hourly pay rate at the time of the request. Upon termination, an employee is paid for unused PTO at 100% of their current hourly pay rate.

2. Extended Illness Benefit

Extended Illness Benefits (EIB) are paid to employees for sick absences in excess of two consecutive days. EIB is accrued for full-time employees at a rate of 55.9 hours per year. Accrued EIB may be carried over from year to year. Depending upon status, employees may accrue EIB to a maximum of 432 to 480 hours. Accrued EIB is not paid to employees upon termination.

PTO is accrued when incurred and reported as a liability.

No liability is recorded for EIB.

K. 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.

II. Detailed Notes

A. Deposits and Investments

1. Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 16-22-3-16 allows a Hospital Governing Board to deposit public funds in a financial institution. The Hospital does not have a deposit policy for custodial credit risk. At December 31, 2009, the Hospital had deposit balances in the amount of \$1,002,882.

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

2. Investments

Authorization for investment activity is stated in Indiana Code 16-22-3-20. As of December 31, 2009, the Hospital had the following investments:

Investment Type	(In Thousands)	
	Primary Government	Investment Maturities (in Years)
	Market Value	Less Than 1
Mutual funds	\$ 2,410	\$ 2,410

Statutory Authorization for Investments

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

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

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

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

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

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

B. Accounts Receivable and Payable

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

	(In Thousands)
<u>Patient Accounts Receivable</u>	
Receivable from patients and their insurance carriers	\$ 9,271
Receivable from Medicare	2,211
Receivable from Medicaid	<u>1,348</u>
Total patient accounts receivable	12,830
Less allowance for uncollectible amounts	<u>7,167</u>
Patient accounts receivable, net	<u><u>\$ 5,663</u></u>
 <u>Accounts Payable and Accrued Expenses</u>	
Payable to employees (including payroll taxes)	\$ 586
Payable to suppliers	<u>569</u>
Total accounts payable and accrued expenses	<u><u>\$ 1,155</u></u>

C. Capital Assets

Capital asset activity for the year ended December 31, 2009, was as follows:

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

<u>Primary Government</u>	(In Thousands)			
	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 241	\$ -	\$ -	\$ 241
Construction in progress	47	5	47	5
Total capital assets, not being depreciated	288	5	47	246
Capital assets, being depreciated:				
Buildings	20,014	2,183	-	22,197
Improvements other than buildings	506	-	-	506
Fixed equipment	2,158	82	-	2,240
Major movable equipment	10,752	409	159	11,002
Totals	33,430	2,674	159	35,945
Less accumulated depreciation for:				
Buildings	4,940	930	-	5,870
Improvements other than buildings	376	30	-	406
Fixed equipment	1,664	57	-	1,721
Major movable equipment	6,304	1,065	139	7,230
Totals	13,284	2,082	139	15,227
Total capital assets, being depreciated, net	20,146	592	20	20,718
Total primary government capital assets, net	\$ 20,434	\$ 597	\$ 67	\$ 20,964

D. Operating Lease

On September 15, 2008 the Hospital signed a five year operating lease agreement with the Veterans Administration (VA). The VA leased a building from the Hospital. Under terms of the agreement, the annual lease cost is recomputed each Federal fiscal year. Payments are monthly. The agreed-upon annual lease cost for the Federal fiscal year ending September 30, 2010, was \$253,467. Through December 31, 2009, the VA paid \$63,367 of the agreed upon amount. The \$190,100 due for the remainder of the Federal fiscal year was not included in the Hospital's financial statements.

E. Short-Term Liabilities

The Hospital used a revolving line of credit and short-term loans/notes to finance the construction of a building.

Short-term debt activity for the year ended December 31, 2009, was as follows:

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

	Beginning Balance	Issued/ Draws	Redeemed Repayments	Ending Balance
Line of credit, loan	\$ 680	\$ 2,320	\$ 3,000	\$ -

F. Net Patient Service Revenue

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

1. Medicare

Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

2. Medicaid

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

Revenue from the Medicare and Medicaid programs accounted for approximately 37 percent and 19 percent, respectively, of the Hospital's net patient revenue for the year ended 2009, and 38 percent and 18 percent, 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 Hospital also has entered into payment agreements with certain commercial insurance carriers, HMO's, and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

G. Disproportionate Share Hospital Payments

Disproportionate Share Hospital (DSH) adjustment payments provide additional funds to hospitals that serve a significantly disproportionate number of low-income patients. States receive an annual DSH allotment from the Federal government to cover the costs of qualifying hospitals that provide care to low-income patients not covered by other payers. The Hospital qualified as a DSH and received \$2,017,000 in 2009. The revenue from the program is included in net patient service revenue.

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

III. Other Information

A. Risk Management

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

B. Management Agreement and Related Fees

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. A procedure was established whereby a management fee was to be paid by the Hospital based on operating income. In 2009, no management fee was paid due to the Hospital incurring an operating loss.

In addition, expenses in the amount of \$1,806,627 were incurred for services performed by Jewish Hospital & St. Mary's HealthCare, Inc., and its related entities. The amount of \$83,453 was due to Jewish Hospital and its affiliates as of December 31, 2009.

C. Subsequent Events

In September 2009, the Board entered into a contract with Medical Information Technology, Inc., (Meditech) for the implementation of a digitized record-keeping system. The Hospital's records were to be converted to the system in 2010. The estimated initial cost of the system was \$1,533,221 with estimated annual maintenance costs of \$261,406.

A portion of the cost of the system will be recovered through increased Medicare reimbursements. Officials have estimated that approximately \$409,000 will be recovered.

D. 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.

SCOTT MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

E. Pension Plan

Defined Contribution Pension Plan

Scott County Memorial Hospital 403 (B) Plan

Plan Description

The Hospital has a defined contribution pension plan administered by American United Life Insurance Company (Plan Administrator) 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 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 in accordance with the Internal Revenue Code. Each employee has a separate account. Employees contribute to their accounts through salary reduction contributions subject to Internal Revenue Code restrictions. The Hospital contributes a matching amount to each employee's account. Account statements are sent to the employees. The Hospital does not receive statements for the employees' accounts.

SCOTT MEMORIAL HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on April 15, 2010, with Angela G. Doan, Treasurer/ Chief Financial Officer; Randy Hancock, Chairman of the Hospital Board; and Clifford D. Nay, President/ Chief Executive Officer. Our audit disclosed no material items that warrant comment at this time.