

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

**AUDIT REPORT
OF**

**DAVISS COMMUNITY HOSPITAL
A COMPONENT UNIT OF
DAVISS COUNTY, INDIANA**

January 1, 2010 to December 31, 2010



FILED
05/09/2011

TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Hospital Officials	2
Independent Auditor's Report	3
Management's Discussion and Analysis.....	4-8
Basic Financial Statements:	
Statement of Net Assets.....	9
Statement of Revenues, Expenses, and Changes in Net Assets	10
Statement of Cash Flows – Restricted and Unrestricted Funds	11
Notes to Financial Statements	12-23
Audit Results and Comments:	
Internal Controls – Board of Governors.....	24
Correction of Errors – Cash Account.....	24
Exit Conference.....	25

HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Executive Director	Gary L. Kendrick	01-01-10 to 12-31-11
Chief Financial Officer	Brad Hardcastle	01-01-10 to 12-31-11
President of the Board of Governors	Kenneth Parsons	07-01-09 to 06-30-11
President of the Board of County Commissioners	Anthony B. Wichman	01-01-10 to 12-31-11



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 DAVIESS COMMUNITY HOSPITAL, DAVIESS COUNTY, INDIANA

We have audited the accompanying basic financial statements of the business-type activities of the Daviess Community Hospital (Hospital) as of and for the year ended December 31, 2010, which collectively comprise the Hospital's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over reporting. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Hospital as of December 31, 2010, and the respective changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, as listed in the Table of Contents, is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

STATE BOARD OF ACCOUNTS

April 7, 2011



Management's Discussion and Analysis

Our discussion and analysis of Daviness Community Hospital's (the Hospital) financial performance provides an overview of the Hospital's financial statements for the fiscal year ended December 31, 2010. Please read it in conjunction with the Hospital's financial statements and accompanying notes to the financial statements. Unless otherwise stated, amounts are presented in millions.

Using This Annual Report

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

- In the ***Management's Discussion and Analysis*** section of this report, the Hospital discusses various components of the annual report and provides an analysis of the current financial statement information.
- The ***Basic Financial Statement*** section of this report includes a series of financial statements which provide information about the activities of the Hospital as a whole. The Statement of Net Assets reveals the assets and liabilities of the Hospital on December 31, 2010 while the Statement of Revenues, Expenses and Changes in Net Assets summarize the change in cash and cash equivalents as a result of the financial activity during the year. The Notes to the Financial Statements disclose additional information addressed within the body of the financial statements.

Financial Highlights

- The Hospital's net assets declined \$1.8 million as a result of this year's operations.
- The Hospital's net operating revenues of \$44.5 million decreased by \$5.4 million or 10.8% from prior year. Gross revenue for inpatients decreased \$3.2 million while outpatient gross revenue decreased \$4.7 million.
- The Hospital's operating expenses of \$46.4 million decreased by \$3.8 million or 7.5% from the prior year. Salaries and benefits decreased \$2.0 million, bad debts decreased by \$1.4 million, and supplies decreased \$0.6 million.

Summarized Financial Statement Information

The following financial reports *Net Assets* and *Changes in Net Assets* document in summary form the financial information related to the activities of the Hospital for Calendar Year 2010 and Prior Year 2009. Related notes follow the financial reports.

NET ASSETS		
	2010	2009
Current Assets	\$13.8	\$10.3
Noncurrent Assets	6.3	12.7
Capital Assets	35.2	34.9
Total Assets	55.3	57.9
Current Liabilities	6.2	5.5
Long-Term Debt	15.5	17.0
Total Liabilities	21.7	22.5
Net Assets		
Invested in Capital Assets	18.2	16.3
Restricted	3.6	3.1
Unrestricted	11.9	16.0
Total Net Assets	\$33.6	\$35.4

Current Assets of \$13.8 million increased \$3.5 million or 34.0% from the prior year. Net receivables increased \$1.5 million and cash increased by \$1.5 million. Noncurrent assets declined by \$6.4 million. Approximately \$5 million has been spent over the past two years on a new information technology system and electronic medical record.

Long-Term Debt of \$15.5 million decreased \$1.5 million or 8.8% from the prior year.

CHANGES IN NET ASSETS		
	2010	2009
Revenue		
Net Patient Service Revenue	\$43.7	\$48.8
Other Revenues	0.8	1.1
Total Revenues	44.5	49.9
Expenses		
Salaries and Benefits	24.1	26.1
Medical Supplies and Drugs	3.8	3.9
Insurance	0.5	0.6
Other Supplies	0.7	1.2
Depreciation and Amortization	3.5	2.7
Other Expenses	13.8	15.7
Total Expenses	46.4	50.2
Operating Loss	-1.9	-0.3
Non-operating Revenues	0.2	0.3
Increase (Decrease) In Net Assets	-1.8	0.0
Net Assets Beginning of the Year	35.4	35.4
Net Assets End of the Year	\$33.6	\$35.4

Net assets declined \$1.8 million from the prior year. Net assets are the difference between net patient service revenues and the expenses incurred to perform those services.

The primary components for net assets in 2010 are:

- The Hospital's net operating revenues of \$44.5 million decreased by \$5.4 million or 10.8% from prior year. Gross inpatient service revenue decreased \$3.2 million and outpatient revenue decreased \$4.7 million.
- The Hospital's operating expenses of \$46.4 million decreased by \$3.8 million or 7.5% from prior year. Salaries and benefits decreased \$2.0 million, bad debts decreased \$1.4 million, and supplies decreased \$0.6 million.

Capital Assets and Debt Administration

Capital Assets

At the end of 2010, the Hospital had \$35.2 million invested in capital assets. The Hospital had a net increase of \$0.3 million over prior year. The table displayed below documents the type of assets that makeup the capital assets held by the hospital as of December 31, 2010.

Capital Assets at Year-End Net of Depreciation		
	2010	2009
Land	\$1.3	\$1.2
Land Improvements/Leasehold Improvements	0.7	0.8
Building	38.4	38.3
Equipment	26.8	21.9
Total	67.2	62.2
Less Accumulated Depreciation	32.2	29.5
Subtotal	35.0	32.7
Construction In Progress	0.2	2.2
Capital Assets (Net)	\$35.2	\$34.9

Debt

At year-end, the Hospital had approximately \$18.2 million in long-term debt (financial statements are shown net of bond discount). The table below documents the debt held.

Outstanding Debt at Year End		
	2010	2009
Variable Rate Hospital Revenue Bonds		
2001 Revenue Bonds	\$0.7	\$1.5
Indiana Health Facility Financing Authority (IHFFA)		
1998/1999 Revenue Bonds	0.0	0.0
2006 Revenue Bond (Refunded 1998 and 1999 series)	17.3	17.9
PACS Capital Lease	0.2	0.4
Total Debt	\$18.2	\$19.8

Contacting the Hospital's Management

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

DAVISS COMMUNITY HOSPITAL
STATEMENT OF NET ASSETS
December 31, 2010

Assets

Current assets:	
Cash and cash equivalents	\$ 1,637,507
Patient accounts receivable, net of estimated uncollectibles of \$6,065,702	7,596,588
Supplies and other current assets	3,710,749
Noncurrent cash and investments:	
Internally designated	2,705,670
Held by trustee for debt service	3,567,423
Capital assets:	
Land and construction in progress	1,532,447
Depreciable capital assets, net of accumulated depreciation	33,700,874
Other assets	<u>817,690</u>
Total assets	<u>\$ 55,268,948</u>

Liabilities and Net Assets

Current liabilities:	
Current maturities of long-term debt	\$ 1,575,431
Accounts payable and accrued expenses	3,365,447
Other current liabilities	1,202,878
Long-term debt, net of current maturities	<u>15,490,360</u>
Total liabilities	<u>21,634,116</u>
Net assets:	
Invested in capital assets, net of related debt	18,167,530
Restricted:	
For debt service	3,569,423
Unrestricted	<u>11,897,879</u>
Total net assets	<u>33,634,832</u>
Total liabilities and net assets	<u>\$ 55,268,948</u>

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

DAVIESS COMMUNITY HOSPITAL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year Ended December 31, 2010

Operating revenues:	
Net patient service revenue (net of provision for bad debt)	\$ 43,667,187
Other	<u>841,489</u>
Total operating revenues	<u>44,508,676</u>
Operating expenses:	
Salaries and benefits	24,122,414
Medical supplies and drugs	3,842,359
Insurance	520,673
Other supplies	653,343
Other expenses	14,247,879
Depreciation and amortization	<u>3,018,575</u>
Total operating expenses	<u>46,405,243</u>
Operating loss	<u>(1,896,567)</u>
Nonoperating revenues:	
Investment income	148,199
Loss on sale of equipment	(38,239)
Other nonoperating expense	(30,701)
Other nonoperating revenue	<u>68,818</u>
Total nonoperating revenues	<u>148,077</u>
Decrease in net assets	(1,748,490)
Net assets beginning of the year	<u>35,383,322</u>
Net assets end of the year	<u><u>\$ 33,634,832</u></u>

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

DAVISS COMMUNITY HOSPITAL
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS
Year Ended December 31, 2010

	<u>2010</u>
Cash flows from operating activities:	
Receipts from and on behalf of patients	\$ 42,171,869
Payments to suppliers and contractors	(4,721,106)
Payments to employees	(24,122,414)
Other receipts and payments, net	<u>(12,623,626)</u>
Net cash provided by operating activities	<u>704,723</u>
Cash flows from capital and related financing activities:	
Principal paid on long-term debt	(1,618,689)
Interest paid on long-term debt	(888,791)
Purchase of capital assets	<u>(3,271,947)</u>
Net cash used by capital and related financing activities	<u>(5,779,427)</u>
Cash flows from investing activities:	
Proceeds from cashing investments	5,050,000
Interest and dividends on investments	<u>148,199</u>
Net increase in cash and cash equivalents	123,495
Cash and cash equivalents at beginning of year	<u>6,287,105</u>
Cash and cash equivalents at end of year	<u>\$ 6,410,600</u>
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents in current assets	\$ 1,637,507
Restricted cash and cash equivalents	<u>4,773,093</u>
Total Cash and Cash Equivalents	<u>\$ 6,410,600</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (1,896,567)
Adjustments to reconcile operating loss to net cash flows used in operating activities:	
Depreciation and amortization	3,018,576
Provision for bad debts	4,105,039
Other nonoperating revenues	38,117
Loss on sale of equipment	(38,239)
(Increase) decrease in current assets:	
Patient accounts receivable	(5,600,359)
Supplies and other current assets	(460,256)
Other assets	3,517
Increase in current liabilities:	
Accounts payable and accrued expenses	755,525
Other current liabilities	<u>779,370</u>
Net cash provided in operating activities	<u>\$ 704,723</u>

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

Daviess Community Hospital (Hospital) is a County-owned facility and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital provides short-term inpatient and outpatient health care.

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

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

The accompanying financial statements present the activities of the Hospital (primary government) and its significant component units. The component units discussed below are included in the Hospital's reporting entity because of the significance of their operational or financial relationships with the Hospital. Blended component units, although legally separate entities, are in substance part of the government's operations and exist solely to provide services for the government; data from these units is combined with data of the primary government. Discretely presented component units are involved in activities of an operational nature independent from the government; their transactions are reported in a separate column in the basic financial statements to emphasize that it is legally separate from the Hospital.

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

Blended Component Units

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

B. Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

C. Assets, Liabilities and Net Assets or Equity

1. Deposits and Investments

Cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less.

Short-term investments are investments with remaining maturities of up to 90 days.

Statutes authorize the Hospital to invest in interest-bearing deposit accounts, passbook savings accounts, certificates of deposit, money market deposit accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as non-operating revenues in the Statement of Revenues, Expenses, and Changes in Net Assets.

2. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Capital Assets

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

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

	Capitalization Threshold	Depreciation Method	Estimated Useful Life
Land improvements	\$ 500	Straight-line	*
Buildings and improvements	500	Straight-line	*
Equipment	500	Straight-line	*

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

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

4. Net Assets

Net assets of the Hospital are classified in three components.

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

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

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

D. Grants and Contributions

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

E. Restricted Resources

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

F. Operating Revenues and Expenses

The Hospital's Statement of Revenues, Expenses, and Changes in Net Assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Hospital's principal activity. Nonexchange revenues, including grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

G. Compensated Absences

The Hospital's policy on paid days off (which includes vacation, sick leave, and holidays) allows full-time employees and regular part-time employees to accrue paid days off, to a maximum of 265 hours.

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

II. Detailed Notes

A. Deposits and Investments

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 5-13-8-1 allows a political subdivision of the State of Indiana to deposit public funds in a financial institution only if the financial institution is a depository eligible to receive state funds; and has a principal office or branch that qualifies to receive public funds of the political subdivision. Balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories. Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

B. Accounts Receivable and Payable

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

Patient Accounts Receivable

Receivable from patients and their insurance carriers	\$ 6,426,939
Receivable from Medicare	5,676,899
Receivable from Medicaid	<u>1,558,452</u>

Total patient accounts receivable	13,662,290
-----------------------------------	------------

Less allowance for uncollectible amounts	<u>6,065,702</u>
--	------------------

Patient accounts receivable, net	<u><u>\$ 7,596,588</u></u>
----------------------------------	----------------------------

Accounts Payable and Accrued Expenses

Payable to employees (including payroll taxes)	\$ 1,111,772
Payable to suppliers	<u>2,253,675</u>

Total accounts payable and accrued expenses	<u><u>\$ 3,365,447</u></u>
---	----------------------------

C. Capital Assets

Capital asset activity for the year ended December 31, 2010, was as follows:

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 1,232,668	\$ 48,287	\$ -	\$ 1,280,955
Construction in progress	2,205,261	1,936,152	3,889,921	251,492
Total capital assets, not being depreciated	<u>3,437,929</u>	<u>1,984,439</u>	<u>3,889,921</u>	<u>1,532,447</u>
Capital assets, being depreciated:				
Land improvements	775,431	-	48,448	726,983
Buildings and improvements	38,330,534	74,956	24,496	38,380,994
Equipment	21,907,338	5,995,634	1,126,783	26,776,189
Totals	<u>61,013,303</u>	<u>6,070,590</u>	<u>1,199,727</u>	<u>65,884,166</u>
Less accumulated depreciation for:				
Land improvements	402,799	9,940	-	412,739
Buildings and improvements	12,406,909	1,053,333	-	13,460,242
Equipment	16,777,055	1,533,256	-	18,310,311
Totals	<u>29,586,763</u>	<u>2,596,529</u>	<u>-</u>	<u>32,183,292</u>
Total capital assets, being depreciated, net	<u>31,426,540</u>	<u>3,474,061</u>	<u>1,199,727</u>	<u>33,700,874</u>
Total primary government capital assets, net	<u>\$ 34,864,469</u>	<u>\$ 5,458,500</u>	<u>\$ 5,089,648</u>	<u>\$ 35,233,321</u>

D. Construction Commitments

Construction work in progress is composed of the following:

<u>Project</u>	<u>Total Project Authorized</u>	<u>Expended to December 31, 2010</u>	<u>Required Future Funding</u>
IT Project	\$ 3,169,800	\$ 22,054	\$ 3,147,746
Capital Equipment	<u>229,438</u>	<u>229,438</u>	<u>-</u>
Totals	<u>\$ 3,399,238</u>	<u>\$ 251,492</u>	<u>\$ 3,147,746</u>

E. Leases

1. Operating Leases

The Hospital has entered into various operating leases having initial or remaining non-cancelable terms exceeding one year for IV Pumps and a Bulk Oxygen Tank. Monthly rental expenditures for these two leases were \$4,251 and \$850, respectively. The following is a schedule by years of future minimum rental payments as of year end:

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

2011	\$ 61,214
2012	61,213
2013	61,214
2014	56,962
2015-2019	<u>46,750</u>
Total minimum rental payments	<u>\$ 287,353</u>

2. Capital Leases

The Hospital has entered into a capital lease for a PACS system. Future minimum lease payments and present values of the net minimum lease payments under the capital lease as of December 31, 2010, are as follows:

2011 Total minimum lease payments	\$ 193,807
Less amount representing interest	<u>3,655</u>
Present value of net minimum lease payments	<u>\$ 190,152</u>

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

Equipment	\$ 1,152,251
Accumulated depreciation	<u>1,017,901</u>
Total	<u>\$ 134,350</u>

F. Long-Term Liabilities

1. Revenue Bonds

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

Purpose	Interest Rates	Amount
2001 Variable rate revenue bonds for hospital construction	Variable	\$ 755,280
2006 Refunding revenue bonds for hospital improvements	Variable	<u>17,270,000</u>
Total		<u>\$ 18,025,280</u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Revenue bonds debt service requirements to maturity are as follows:

Year Ended December 31	Principal	Interest
2011	\$ 1,385,280	\$ 636,091
2012	655,000	591,885
2013	680,000	568,718
2014	710,000	544,273
2015	730,000	519,144
2016-2020	4,120,000	2,184,360
2021-2025	4,995,000	1,391,910
2026-2030	<u>4,750,000</u>	<u>430,368</u>
Totals	<u>\$ 18,025,280</u>	<u>\$ 6,866,749</u>

2. Advance Refunding

In prior years, the Hospital defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments of the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Hospital's financial statements. The following outstanding bonds, at December 31, 2010, were considered defeased:

	<u>Amount</u>
Hospital	<u>\$14,755,000</u>

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2010, was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable:					
Revenue:					
Hospital Association	\$ 1,510,560	\$ -	\$ 755,280	\$ 755,280	\$ 755,280
Other revenue bonds	17,875,000	-	605,000	17,270,000	630,000
Less deferred amount on refunding	<u>1,210,320</u>	<u>-</u>	<u>60,680</u>	<u>1,149,640</u>	<u>-</u>
Total bonds payable	18,175,240	-	1,299,600	16,875,640	1,385,280
Capital leases	<u>433,734</u>	<u>-</u>	<u>258,409</u>	<u>190,152</u>	<u>190,152</u>
Total long-term liabilities	<u>\$ 18,608,974</u>	<u>\$ -</u>	<u>\$ 1,558,009</u>	<u>\$ 17,065,792</u>	<u>\$ 1,575,432</u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Net Revenue Available for Debt Service

The following disclosures concerning net revenue available for debt service applicable to the years ended December 31, 2010, are required by terms of the financing agreement between the Hospital and IHFFA:

Revenue from operations	\$ 44,508,676
Investment income	148,199
Net loss on disposal of assets	(38,239)
Less:	
Expenses (excluding depreciation, amortization and interest on funded debt)	<u>42,060,041</u>
Total net revenue available for debt service	<u><u>\$ 2,558,595</u></u>
Funded debt service for year	<u><u>\$ 2,324,402</u></u>
Historical debt service coverage ratio	<u><u>1.10</u></u>

G. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were \$1,428,596 for 2010.

H. Internally Designated Assets

Noncurrent cash and investments internally designated include the following:

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

Internally designated:	
Funded depreciation:	
Investments	\$ 2,093,000
Board designation:	
Cash and cash equivalents	<u>612,670</u>
Total internally designated	<u><u>\$ 2,705,670</u></u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

I. Net Patient Services Revenue

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

1. Medicare

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

2. Medicaid

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

Revenue from the Medicare and Medicaid programs accounted for approximately 42.9% and 6.0%, respectively, of the Hospital's net patient revenue for the year ended December 31, 2010, and 40.5% and 8.2%, respectively, of the Hospital's net patient revenue for the year ended December 31, 2009. 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 2010 net patient service revenue increased approximately \$10,842 as a result of interim settlements for prior years.

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

III. Other Information

A. Risk Management

The Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); and natural disasters.

The risks of torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); and natural disasters are covered by commercial insurance from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. There were no significant reductions in insurance by major category of risk.

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Medical Benefits to Employees

The Hospital has chosen to establish a risk financing fund for risks associated with medical benefits to employees. The risk financing fund is accounted for in the operating fund where assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of \$70,000 per year. Settled claims resulting from this risk did not exceed commercial insurance coverage in the past three years.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported (IBNRs). Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of payouts and other economic and social factors.

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

	<u>2010</u>	<u>2009</u>
Unpaid claims, beginning of fiscal year	\$ 204,131	\$ 184,689
Incurred claims and changes in estimates	2,397,465	2,469,018
Claim payments	<u>(2,384,796)</u>	<u>(2,449,576)</u>
Unpaid claims, end of fiscal year	<u>\$ 216,800</u>	<u>\$ 204,131</u>

B. Contingent Liabilities

Litigation

The Hospital is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations.

C. Postemployment Benefits

In addition to the pension benefits described in Note III-G, the Hospital provides postemployment health insurance benefits, as authorized by IC 5-10-8, to all employees who retire from the Hospital on or after attaining age 62 with at least 10 years of service. Currently, four retirees meet these eligibility requirements. The Hospital provides 56% to 58% of these postemployment benefits. Expenditures for those postemployment benefits are recognized on a pay-as-you-go basis. During the year ended December 31, 2010, expenditures of \$1,433 were recognized for postemployment benefits.

D. Fair Value of Financial Instruments

The following methods and assumptions were used by the Hospital in estimating the fair value of its financial instruments:

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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.

E. Fair Value Measurements

The Hospital has characterized its investments in securities, based on the priority of the inputs used to value the investments, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities [Level 1], and the lowest priority to unobservable inputs [Level 3]. If the inputs used to measure the investments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the investment.

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

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

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

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

Based upon the levels as defined the Hospital's investments as of December 31, 2010, are classified as follows:

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Investment Type	December 31, 2010	Fair value measurements at reporting date using:		
		Quoted prices in active markets identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Certificates of deposit	\$ 2,093,000	\$ -	\$ 2,093,000	\$ -

F. Estimated Third-Party Settlements

Regulations in effect require annual retroactive settlements for third-party settlements based upon cost reports filed by the Hospital. These retroactive settlements are estimated and recorded in the accompanying financial statements. Changes in these estimates are reflected in the year in which they occur. During 2010, net patient service revenues in the accompanying statements of operations were increased by \$10,842, to reflect changes in the estimated settlements for certain prior years.

G. Pension Plan

Daviess Community Hospital Money Purchase Plan

Plan Description

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

Principal Mutual Life Insurance Company
711 High Street
Des Moines, IA 50392-0001

Ph. (515) 247-5111

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

H. Subsequent Event Note

The Hospital is actively involved in a County Hospital Association Lease Financing for the purposes of refinancing the 2006 bond issue. The refinancing is expected to close in late April 2011.

DAVIESS COMMUNITY HOSPITAL
AUDIT RESULTS AND COMMENTS

INTERNAL CONTROLS - BOARD OF GOVERNORS

Controls for the disbursements generated by the accounts payable department are insufficient. The Board of Governors does not approve checks before printing and mailing. The Board approves the monthly accounts payable on a consent agenda after the fact.

IC 16-22-3-7 states:

"Claims against the hospital must be allowed and approved by the governing board before payment by the disbursing officer. However, the board may, subject to review and approval at the board's next regular meeting, authorize the following:

- (1) Compensation of hospital employees upon certification of payrolls by the executive director.
- (2) Payment of invoices for materials, services, equipment, and supplies required for the operation and maintenance of the hospital upon certification by the executive director of the following:
 - (A) The invoices are true and correct.
 - (B) The items were ordered and received by the hospital.

The claim or invoice furnished by the supplier need not contain the certificate provided for in IC 5-11-10-1."

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

CORRECTION OF ERRORS - CASH ACCOUNT

The cash account on the Hospital's general ledger was adjusted by \$9,357.35 on December 31, 2010, to enable reconciliation with the bank account. The entry lowered the cash account balance by \$9,357.35 which results in a "cash necessary to balance" issue to reconcile accounts.

It was also noted that reconciliements were not performed on a timely basis, thus the hospital was unable to discover and correct errors as they occurred.

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

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

DAVIESS COMMUNITY HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on April 7, 2011, with Brad Hardcastle, Chief Financial Officer; Anthony R. Showalter, Vice President of the Board of Governors; Kenneth Parsons, President of the Board of Governors; and Ann Perkins, Controller. The officials concurred with our audit findings.