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June 17, 2011

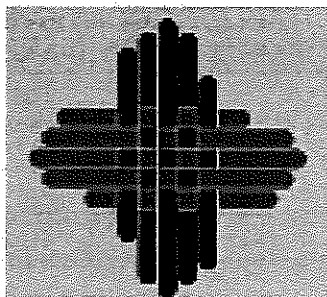
Board of Directors  
Jackson County Schneck Memorial Hospital  
411 West Tipton Street  
P.O. Box 2349  
Seymour, IN 47274-5000

We have reviewed the audit report prepared by Blue & Co., LLC, Independent Public Accountants, for the period January 1, 2010 to December 31, 2010. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Jackson County Schneck Memorial Hospital, as of December 31, 2010 and the results of its operations for the period then ended, on the basis of accounting described in the report.

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

STATE BOARD OF ACCOUNTS

TAA:csc



# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AND**

**SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2010 AND 2009**

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

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DECEMBER 31, 2010 AND 2009**

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blueandco.com

## REPORT OF INDEPENDENT AUDITORS

Board of Trustees  
Jackson County Schneck Memorial Hospital  
and Affiliated Organizations  
Seymour, Indiana

We have audited the accompanying consolidated balance sheets of Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) and Affiliated Organizations (collectively the "Medical Center"), component units of Jackson County, as of December 31, 2010 and 2009, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the auditing standards generally accepted in the United States of America and the Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of December 31, 2010 and 2009, and the results of its operations and changes in its net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

**Blue & Co., LLC**

April 21, 2011

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009**

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Management's discussion and analysis of the financial performance of Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) (the "Hospital") and Affiliated Organizations (collectively the "Medical Center") provides an overview of the Medical Center's financial activities and performance for the years ended December 31, 2010 and 2009. This discussion and analysis should be read in conjunction with the accompanying Medical Center's consolidated financial statements.

### **FINANCIAL HIGHLIGHTS**

The Medical Center's net assets increased \$10,162,405 from 2009 to 2010 and included income from operations of \$8,331,015. During 2010, the Medical Center's total operating revenue increased by 3.7% to \$99,594,796 with total operating expenses decreasing by 1.7% to \$91,263,781.

- Effective July 1, 2010, future benefit accruals for the Medical Center's defined benefit pension plan were frozen. At the same time, the Medical Center amended its 403(b) defined contribution plan to allow for employer discretionary and matching contributions. The Medical Center's contribution for 2010 was \$526,000.
- A 2010 overall rate increase on gross charges of 6% was implemented and effective January 1, 2010.

The Medical Center's net assets increased \$7,720,257 from 2008 to 2009 and included income from operations of \$3,190,578. During 2009, the Medical Center's total operating revenue decreased by 3.1% to \$95,998,538 with total operating expenses increasing by 6.8% to \$92,807,960.

- In 2006, the Medical Center began construction on an expansion and renovation project with an anticipated total cost of \$60,354,228. Upon completion in 2009, the actual total cost of the project was \$57,237,000. Renovation of 90,600 square feet of existing space was completed in 2009. During 2009, a total of \$1,235,426 was spent toward the project.
- The Medical Center opened an outpatient physician clinic in Washington County, Indiana in March 2009 at a cost of \$462,745 for equipment and building fixtures.
- A 2009 overall rate increase on gross charges of 7.8% was implemented and effective January 1, 2009.

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009**

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### **FINANCIAL STATEMENTS**

The consolidated financial statements of the Medical Center present information about the Medical Center using financial reporting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information. The Consolidated Balance Sheets include all of the Medical Center's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to the Medical Center's creditors (liabilities). It also provides the basis for compiling rate of return, evaluating the capital structure of the Medical Center and assessing the liquidity and financial flexibility of the Medical Center. All of the current and prior year's revenues and expenses are accounted for in the Consolidated Statements of Operations and Changes in Net Assets. This statement measures the financial results of the Medical Center's operations and presents revenues earned and expenses incurred. The Consolidated Statements of Cash Flows provide information about the Medical Center's cash flows from operating activities, capital and related financing activities, and investing activities, plus provide information on the sources and uses of cash during both the current and prior year.

### **FINANCIAL ANALYSIS**

The Consolidated Balance Sheets and the Consolidated Statements of Operations and Changes in Net Assets report information about the Medical Center's activities. These two statements report the net assets of the Medical Center and its changes. Increases or decreases in the Medical Center's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, population changes (including uninsured and medically indigent individuals and families) and new or changed governmental legislation should also be considered.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

### CONDENSED FINANCIAL INFORMATION

A summary of the Medical Center's Consolidated Balance Sheets as of December 31, 2010 and 2009 is presented below:

|                                                  | 2010                  | 2009                  | \$ Change            | % Change    |
|--------------------------------------------------|-----------------------|-----------------------|----------------------|-------------|
| <b>Assets</b>                                    |                       |                       |                      |             |
| Cash and investments                             | \$ 123,531,449        | \$ 109,511,856        | \$ 14,019,593        | 12.8%       |
| Capital assets                                   | 78,482,202            | 81,740,833            | (3,258,631)          | -4.0%       |
| Other assets                                     | 25,116,216            | 24,742,250            | 373,966              | 1.5%        |
| <b>Total assets</b>                              | <b>\$ 227,129,867</b> | <b>\$ 215,994,939</b> | <b>\$ 11,134,928</b> | <b>5.2%</b> |
| <b>Liabilities</b>                               |                       |                       |                      |             |
| Long-term debt, including current portion        | \$ 50,571,258         | \$ 52,443,606         | \$ (1,872,348)       | -3.6%       |
| Other current and noncurrent liabilities         | 19,699,913            | 16,855,042            | 2,844,871            | 16.9%       |
| <b>Total liabilities</b>                         | <b>70,271,171</b>     | <b>69,298,648</b>     | <b>972,523</b>       | <b>1.4%</b> |
| <b>Net assets</b>                                |                       |                       |                      |             |
| Investment in capital assets net of related debt | 27,910,944            | 29,297,227            | (1,386,283)          | -4.7%       |
| Restricted expendable net assets                 | 4,490,537             | 6,324,351             | (1,833,814)          | -29.0%      |
| Restricted nonexpendable net assets              | 312,249               | 292,807               | 19,442               | 6.6%        |
| Unrestricted                                     | 124,144,966           | 110,781,906           | 13,363,060           | 12.1%       |
| <b>Total net assets</b>                          | <b>156,858,696</b>    | <b>146,696,291</b>    | <b>10,162,405</b>    | <b>6.9%</b> |
| <b>Total liabilities and net assets</b>          | <b>\$ 227,129,867</b> | <b>\$ 215,994,939</b> | <b>\$ 11,134,928</b> | <b>5.2%</b> |

A summary of the Medical Center's Consolidated Balance Sheets as of December 31, 2009 and 2008 is presented below:

|                                                  | 2009                  | 2008                  | \$ Change           | % Change     |
|--------------------------------------------------|-----------------------|-----------------------|---------------------|--------------|
| <b>Assets</b>                                    |                       |                       |                     |              |
| Cash and investments                             | \$ 109,511,856        | \$ 99,925,256         | \$ 9,586,600        | 9.6%         |
| Capital assets                                   | 81,740,833            | 83,057,419            | (1,316,586)         | -1.6%        |
| Other assets                                     | 24,742,250            | 25,891,478            | (1,149,228)         | -4.4%        |
| <b>Total assets</b>                              | <b>\$ 215,994,939</b> | <b>\$ 208,874,153</b> | <b>\$ 7,120,786</b> | <b>3.4%</b>  |
| <b>Liabilities</b>                               |                       |                       |                     |              |
| Long-term debt, including current portion        | \$ 52,443,606         | \$ 53,686,795         | \$ (1,243,189)      | -2.3%        |
| Other current and noncurrent liabilities         | 16,855,042            | 16,211,324            | 643,718             | 4.0%         |
| <b>Total liabilities</b>                         | <b>69,298,648</b>     | <b>69,898,119</b>     | <b>(599,471)</b>    | <b>-0.9%</b> |
| <b>Net assets</b>                                |                       |                       |                     |              |
| Investment in capital assets net of related debt | 29,297,227            | 29,370,624            | (73,397)            | -0.2%        |
| Restricted expendable net assets                 | 6,324,351             | 6,361,767             | (37,416)            | -0.6%        |
| Restricted nonexpendable net assets              | 292,807               | 246,916               | 45,891              | 18.6%        |
| Unrestricted                                     | 110,781,906           | 102,996,727           | 7,785,179           | 7.6%         |
| <b>Total net assets</b>                          | <b>146,696,291</b>    | <b>138,976,034</b>    | <b>7,720,257</b>    | <b>5.6%</b>  |
| <b>Total liabilities and net assets</b>          | <b>\$ 215,994,939</b> | <b>\$ 208,874,153</b> | <b>\$ 7,120,786</b> | <b>3.4%</b>  |

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

### CONDENSED FINANCIAL INFORMATION

A summary of the Medical Center's Consolidated Statements of Operations and Changes in Net Assets for the years ended December 31, 2010 and 2009 is presented below:

|                                  | 2010                  | 2009                  | \$ Change            | % Change |
|----------------------------------|-----------------------|-----------------------|----------------------|----------|
| <b>Operating revenues</b>        |                       |                       |                      |          |
| Net patient service revenue      | \$ 98,530,200         | \$ 94,881,926         | \$ 3,648,274         | 3.8%     |
| Other revenue                    | <u>1,064,596</u>      | <u>1,116,612</u>      | <u>(52,016)</u>      | -4.7%    |
| Total operating revenues         | 99,594,796            | 95,998,538            | 3,596,258            | 3.7%     |
| <b>Operating expenses</b>        |                       |                       |                      |          |
| Salaries and benefits            | 52,280,700            | 53,506,722            | (1,226,022)          | -2.3%    |
| Supplies and drugs               | 16,880,709            | 17,282,645            | (401,936)            | -2.3%    |
| Depreciation and amortization    | 8,519,194             | 8,020,524             | 498,670              | 6.2%     |
| Other operating expenses         | <u>13,583,178</u>     | <u>13,998,069</u>     | <u>(414,891)</u>     | -3.0%    |
| Total operating expenses         | <u>91,263,781</u>     | <u>92,807,960</u>     | <u>(1,544,179)</u>   | -1.7%    |
| Income from operations           | 8,331,015             | 3,190,578             | 5,140,437            | 161.1%   |
| <b>Nonoperating revenues</b>     | <u>1,811,948</u>      | <u>4,483,788</u>      | <u>(2,671,840)</u>   | -59.6%   |
| Excess revenues                  | 10,142,963            | 7,674,366             | 2,468,597            | 32.2%    |
| <b>Change in perpetual trust</b> | <u>19,442</u>         | <u>45,891</u>         | <u>(26,449)</u>      | -57.6%   |
| Change in net assets             | <u>\$ 10,162,405</u>  | <u>\$ 7,720,257</u>   | <u>\$ 2,442,148</u>  | 31.6%    |
| <b>Net assets, end of year</b>   | <u>\$ 156,858,696</u> | <u>\$ 146,696,291</u> | <u>\$ 10,162,405</u> | 6.9%     |

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

A summary of the Medical Center's Consolidated Statements of Operations and Changes in Net Assets for the years ended December 31, 2009 and 2008 is presented below:

|                                         | 2009                  | 2008                  | \$ Change           | % Change |
|-----------------------------------------|-----------------------|-----------------------|---------------------|----------|
| <b>Operating revenues</b>               |                       |                       |                     |          |
| Net patient service revenue             | \$ 94,881,926         | \$ 97,863,607         | \$ (2,981,681)      | -3.0%    |
| Other revenue                           | <u>1,116,612</u>      | <u>1,173,125</u>      | <u>(56,513)</u>     | -4.8%    |
| Total operating revenues                | 95,998,538            | 99,036,732            | (3,038,194)         | -3.1%    |
| <b>Operating expenses</b>               |                       |                       |                     |          |
| Salaries and benefits                   | 53,506,722            | 50,860,200            | 2,646,522           | 5.2%     |
| Supplies and drugs                      | 17,282,645            | 17,689,778            | (407,133)           | -2.3%    |
| Depreciation and amortization           | 8,020,524             | 5,417,714             | 2,602,810           | 48.0%    |
| Other operating expenses                | <u>13,998,069</u>     | <u>12,899,506</u>     | <u>1,098,563</u>    | 8.5%     |
| Total operating expenses                | <u>92,807,960</u>     | <u>86,867,198</u>     | <u>5,940,762</u>    | 6.8%     |
| Income from operations                  | 3,190,578             | 12,169,534            | (8,978,956)         | -73.8%   |
| <b>Nonoperating revenues (expenses)</b> | <u>4,483,788</u>      | <u>(8,465,929)</u>    | <u>12,949,717</u>   | 153.0%   |
| Excess revenues                         | 7,674,366             | 3,703,605             | 3,970,761           | 107.2%   |
| <b>Change in perpetual trust</b>        | <u>45,891</u>         | <u>(147,786)</u>      | <u>193,677</u>      | 131.1%   |
| Change in net assets                    | <u>\$ 7,720,257</u>   | <u>\$ 3,555,819</u>   | <u>\$ 4,164,438</u> | 117.1%   |
| <b>Net assets, end of year</b>          | <u>\$ 146,696,291</u> | <u>\$ 138,976,034</u> | <u>\$ 7,720,257</u> | 5.6%     |

## SOURCES OF REVENUE

The Medical Center derives the majority of its revenue from charges for patient care and related services. The Medical Center is reimbursed for services from a variety of sources including the Medicare and Medicaid programs, insurance carriers, managed care plans, and patients. The Medical Center has established payment arrangements with Medicare, Medicaid and various commercial insurance carriers. Services provided under those arrangements are paid at predetermined rates and/or reimbursable cost as defined. Provisions have been made in the consolidated financial statements for contractual adjustments representing the difference between the standard charges for services and the actual or estimated payment.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

The Medical Center's percentages of gross revenue by payor for 2010, 2009, and 2008 are as follows:

| <u>Payor Mix</u>     | <u>2010</u>  | <u>2009</u>  | <u>2008</u>  |
|----------------------|--------------|--------------|--------------|
| Medicare             | 38 %         | 39 %         | 40 %         |
| Medicaid             | 12           | 11           | 9            |
| Commercial Insurance | 10           | 10           | 11           |
| Blue Cross           | 24           | 23           | 25           |
| SIHO                 | 9            | 10           | 9            |
| Self-pay             | 6            | 6            | 5            |
| Other                | 1            | 1            | 1            |
|                      | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> |
| Total                |              |              |              |

## OPERATING AND FINANCIAL PERFORMANCE

The Medical Center's financial performance from operations improved in 2010 in comparison to 2009 and the Medical Center's overall financial performance improved from 2009 to 2010. A discussion of the highlights of 2010 operations and changes in activity is presented below:

### Revenues

The Medical Center's net patient service revenues increased by \$3,648,274 in 2010. This is primarily due to implementation of a rate increase and a greater number of surgeries performed as compared to the prior year. Highlights of revenue activity are as follows:

- The Medical Center implemented an overall rate increase of 6% effective January 1, 2010. Patient volume increases were noted for surgeries, as well as birth, occupational therapy, home-health care, and speech therapy. Patient volume decreases were noted in respiratory therapy, physical therapy, radiology, laboratory, and hospice services. Bad debt expense increased by \$627,582 or 5.0%.

### Expenses

Total operating expenses decreased by \$1,544,179 in 2010. Highlights of this change are as follows:

- Employee benefits decreased \$999,130, or 7.0%, due to the implementation of a "spousal carve-out" policy relating to employee health insurance, which requires the spouses of the Medical Center's employees to utilize their own employer's health benefits, if available. Supplies and drugs decreased by \$401,936, or 2.3%, due to the increased utilization of vendors which are included in the Medical Center's group

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009**

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purchasing organization and provide lower prices. Insurance expense decreased by \$264,589, or 20.9%, due to reductions in malpractice insurance premiums.

The Medical Center's financial performance from operations declined in 2009 in comparison to 2008, while the Medical Center's overall financial performance improved from 2008 to 2009. A discussion of the highlights of 2009 operations and changes in activity is presented below:

### **Revenues**

The Medical Center's net patient service revenues decreased by \$2,981,681 in 2009 as a result of volume decreases in most areas. Patient volume in 2008 was abnormally high due to the temporary closure of Columbus Regional Hospital. Volumes have returned to typical levels in 2009 with the exception of the emergency services, which continues to operate at a higher volume than prior to the flood related closure. Highlights of revenue activity are as follows:

- The Medical Center implemented an overall rate increase of 7.8% effective January 1, 2009. Patient volume decreases were noted in surgery, respiratory therapy, inpatient services, births, rehabilitation services, laboratory, and diagnostic imaging services. Bad debt expense decreased by \$2,488,294 or 16.5%. Medicaid volumes increased from 9% of total gross patient revenue in 2008 to 11% in 2009.

### **Expenses**

Total operating expenses increased by \$5,940,762 in 2009. Highlights of this change are as follows:

- Employee salaries and wages decreased \$1,486,472 or 3.7% due to less staffing required during 2009 as volumes returned to normal levels from the Columbus Regional Hospital closure. Employee benefits increased \$4,033,937 or 39.3% due to an increase in employer health insurance expense. Depreciation expense increased \$2,580,111 or 48.1% due to addition of cancer services center in 2007, completion of an 84,000 square foot addition to the Hospital in 2008, and renovation of existing Hospital space in 2009.

### **Nonoperating Revenues**

Nonoperating revenues decreased \$2,671,840 or 59.6% from 2009 to 2010 due mainly to the reduction of investment income returns. Nonoperating revenues increased \$12,949,717 or 153.0% from 2008 to 2009 based on the substantial recovery of investment income resulting from the stock market's extreme downturn that began in October 2008.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

### FINANCIAL ANALYSIS – CASH FLOWS

The Medical Center's 2010 cash flows increased \$15,947,670 due primarily to positive cash inflows received for patient services and investment income, which exceeded cash outflows for cash paid to employees and vendors and purchases of capital assets.

The Medical Center's 2009 cash flows increased \$19,790,782 due primarily to positive cash inflows received for patient services, investment income, and changes in investments, which offset cash outflows for cash paid to employees and vendors, purchases of capital assets, and changes in assets whose use is limited.

#### Capital Assets

|                               | 2010                 | 2009                 | \$Change              | %Change |
|-------------------------------|----------------------|----------------------|-----------------------|---------|
| Land and land improvements    | \$ 10,103,434        | \$ 9,341,204         | \$ 762,230            | 8.2%    |
| Leasehold improvements        | 854,508              | 854,508              | -0-                   | 0.0%    |
| Buildings                     | 74,180,633           | 73,092,995           | 1,087,638             | 1.5%    |
| Equipment                     | 44,818,221           | 43,002,571           | 1,815,650             | 4.2%    |
| Construction in progress      | <u>444,442</u>       | <u>403,479</u>       | <u>40,963</u>         | 10.2%   |
|                               | 130,401,238          | 126,694,757          | 3,706,481             | 2.9%    |
| Less accumulated depreciation | <u>51,919,036</u>    | <u>44,953,924</u>    | <u>6,965,112</u>      | 15.5%   |
| Capital assets, net           | <u>\$ 78,482,202</u> | <u>\$ 81,740,833</u> | <u>\$ (3,258,631)</u> | -4.0%   |

Net capital assets decreased in 2010 due primarily to annual depreciation and the disposal of assets that have exhausted their useful lives being greater than capital expenditures.

|                               | 2009                 | 2008                 | \$Change              | %Change |
|-------------------------------|----------------------|----------------------|-----------------------|---------|
| Land and land improvements    | \$ 9,341,204         | \$ 9,417,095         | \$ (75,891)           | -0.8%   |
| Leasehold improvements        | 854,508              | 505,575              | 348,933               | 69.0%   |
| Buildings                     | 73,092,995           | 67,666,856           | 5,426,139             | 8.0%    |
| Equipment                     | 43,002,571           | 41,323,831           | 1,678,740             | 4.1%    |
| Construction in progress      | <u>403,479</u>       | <u>3,603,254</u>     | <u>(3,199,775)</u>    | -88.8%  |
|                               | 126,694,757          | 122,516,611          | 4,178,146             | 3.4%    |
| Less accumulated depreciation | <u>44,953,924</u>    | <u>39,459,192</u>    | <u>5,494,732</u>      | 13.9%   |
| Capital assets, net           | <u>\$ 81,740,833</u> | <u>\$ 83,057,419</u> | <u>\$ (1,316,586)</u> | -1.6%   |

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009**

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Net capital assets decreased in 2009 due primarily to annual depreciation and the disposal of assets that have exhausted their useful lives being greater than capital expenditures.

### **Long-Term Debt**

At December 31, 2010, the Medical Center had long-term debt (including current portion) of \$50,571,258. This is comprised of \$50,187,992 in revenue bonds outstanding, and \$383,266 in notes payable.

Originally issued in 1998 to finance renovation of the obstetrics nursing area, provide funds for purchase of information system, and defeasance of Series 1991 bonds, Series 1998 revenue bonds were refunded in December 2010. The refunding Series 2010 revenue bonds maintain the same maturity date as the original 1998 issue and carry a fixed interest rate.

At December 31, 2009, the Medical Center had long-term debt (including current portion) of \$52,443,606. This is comprised of \$52,286,376 in revenue bonds outstanding, and \$157,230 in notes payable.

### **ECONOMIC FACTORS AND 2011 BUDGET**

The Medical Center's Board and management considered many factors when establishing the 2011 Budget. Included was the status of the economy, which takes into consideration market factors and other environmental factors such as the following items:

- Advances in medical equipment and information systems technology and the need to replace obsolete equipment
- Decreasing reimbursement from governmental and commercial insurance payors
- Increasing number of uninsured, underinsured and/or indigent patients
- Increasing costs of medical supplies and pharmaceuticals
- Nationwide workforce shortages in nursing and other healthcare specialist positions
- Increasing awareness and expectations from the public on the quality of services
- Increased competition from niche providers
- Size, composition, and needs of the Medical Center's physician medical staff

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2010 AND 2009**

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## **CONTACTING THE MEDICAL CENTER**

This report is designed to provide our citizens, customers and creditors with a general overview of the Medical Center's finances. These consolidated financial statements include the activities of the Hospital, Jackson County Schneck Memorial Hospital Foundation (the "Foundation"), and Health Development Corporation and Affiliated Organization ("HDC"). Separately-issued audited financial statements are available for both HDC and the Foundation. If you have questions about this report or need additional information, contact Warren Forgey, Vice President of Fiscal Services at 812-522-0172.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2010 AND 2009

### ASSETS

|                                                                                                               | 2010                  | 2009                  |
|---------------------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| <b>Current assets</b>                                                                                         |                       |                       |
| Cash and cash equivalents                                                                                     | \$ 38,174,498         | \$ 28,782,628         |
| Investments                                                                                                   | 2,000,000             | 6,250,000             |
| Patient accounts receivable, net of estimated uncollectibles of \$14,351,049 in 2010 and \$12,903,315 in 2009 | 12,758,911            | 11,540,830            |
| Inventories                                                                                                   | 3,464,098             | 3,427,789             |
| Prepaid expenses and other current assets                                                                     | 625,692               | 529,227               |
| Physician recruitment guarantees, current portion                                                             | 671,667               | 616,667               |
| Other assets, current portion                                                                                 | 303,745               | 601,516               |
| Current portion of assets whose use is limited                                                                | 839,097               | 1,874,374             |
| Total current assets                                                                                          | 58,837,708            | 53,623,031            |
| <b>Assets whose use is limited, net of amount required to meet current obligations</b>                        | 82,517,854            | 72,604,854            |
| <b>Capital assets</b>                                                                                         |                       |                       |
| Land                                                                                                          | 6,258,175             | 5,491,936             |
| Land improvements                                                                                             | 3,845,259             | 3,849,268             |
| Leasehold improvements                                                                                        | 854,508               | 854,508               |
| Buildings                                                                                                     | 74,180,633            | 73,092,995            |
| Fixed equipment                                                                                               | 5,960,833             | 5,749,776             |
| Movable equipment                                                                                             | 38,857,388            | 37,252,795            |
|                                                                                                               | 129,956,796           | 126,291,278           |
| Less accumulated depreciation                                                                                 | 51,919,036            | 44,953,924            |
|                                                                                                               | 78,037,760            | 81,337,354            |
| Construction in progress                                                                                      | 444,442               | 403,479               |
| Capital assets, net                                                                                           | 78,482,202            | 81,740,833            |
| <b>Other long-term assets</b>                                                                                 |                       |                       |
| Physician recruitment guarantees, net of current portion                                                      | 204,167               | 905,000               |
| Other assets, net of current portion                                                                          | 7,087,936             | 7,121,221             |
| Total other long-term assets                                                                                  | 7,292,103             | 8,026,221             |
| <b>Total assets</b>                                                                                           | <b>\$ 227,129,867</b> | <b>\$ 215,994,939</b> |

*See accompanying notes to consolidated financial statements.*

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2010 AND 2009

### LIABILITIES AND NET ASSETS

|                                                          | 2010                              | 2009                              |
|----------------------------------------------------------|-----------------------------------|-----------------------------------|
| <b>Current liabilities</b>                               |                                   |                                   |
| Accounts payable                                         | \$ 1,891,202                      | \$ 1,612,502                      |
| Accrued payroll and payroll withholdings                 | 2,454,643                         | 1,451,937                         |
| Accrued expenses                                         | 4,949,426                         | 5,666,544                         |
| Estimated third-party payor settlements                  | 3,850,000                         | 766,448                           |
| Physician recruitment guarantees, current portion        | 671,667                           | 616,667                           |
| Current portion of long-term debt                        | 528,599                           | 1,229,912                         |
| Total current liabilities                                | <u>14,345,537</u>                 | <u>11,344,010</u>                 |
| <b>Long-term liabilities</b>                             |                                   |                                   |
| Long-term debt, net of current portion                   | 50,042,659                        | 51,213,694                        |
| Deferred compensation liabilities                        | 5,619,326                         | 5,776,462                         |
| Physician recruitment guarantees, net of current portion | 204,167                           | 905,000                           |
| Deferred costs                                           | 59,482                            | 59,482                            |
| Total long-term liabilities                              | <u>55,925,634</u>                 | <u>57,954,638</u>                 |
| <br>Total liabilities                                    | <br>70,271,171                    | <br>69,298,648                    |
| <b>Net assets</b>                                        |                                   |                                   |
| Invested in capital assets net of related debt           | 27,910,944                        | 29,297,227                        |
| Restricted                                               |                                   |                                   |
| Expendable for debt service                              | 3,419,186                         | 4,931,451                         |
| Expendable for donor-designated purposes                 | 1,071,351                         | 1,392,900                         |
| Nonexpendable perpetual trust                            | 312,249                           | 292,807                           |
| Unrestricted                                             | <u>124,144,966</u>                | <u>110,781,906</u>                |
| <br>Total net assets                                     | <br><u>156,858,696</u>            | <br><u>146,696,291</u>            |
| <br><br><br>Total liabilities and net assets             | <br><br><br><u>\$ 227,129,867</u> | <br><br><br><u>\$ 215,994,939</u> |

*See accompanying notes to consolidated financial statements.*

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2010 AND 2009

|                                      | 2010                  | 2009                  |
|--------------------------------------|-----------------------|-----------------------|
| <b>Operating revenues</b>            |                       |                       |
| Net patient service revenue          | \$ 98,530,200         | \$ 94,881,926         |
| Other revenue                        | <u>1,064,596</u>      | <u>1,116,612</u>      |
| Total operating revenues             | 99,594,796            | 95,998,538            |
| <b>Operating expenses</b>            |                       |                       |
| Salaries and wages                   | 38,972,041            | 39,198,933            |
| Employee benefits and payroll taxes  | 13,308,659            | 14,307,789            |
| Professional medical fees            | 1,368,806             | 968,887               |
| Medical supplies                     | 8,977,999             | 8,950,031             |
| Other supplies                       | 1,752,432             | 1,999,099             |
| Drugs                                | 6,150,278             | 6,333,515             |
| Purchased services                   | 7,173,727             | 7,236,798             |
| Utilities                            | 1,220,739             | 1,356,414             |
| Insurance                            | 1,002,378             | 1,266,967             |
| Depreciation and amortization        | 8,519,194             | 8,020,524             |
| Rent                                 | 982,694               | 1,025,461             |
| Other operating expenses             | <u>1,834,834</u>      | <u>2,143,542</u>      |
| Total operating expenses             | <u>91,263,781</u>     | <u>92,807,960</u>     |
| Income from operations               | 8,331,015             | 3,190,578             |
| <b>Nonoperating revenues</b>         | <u>1,811,948</u>      | <u>4,483,788</u>      |
| Excess revenues                      | 10,142,963            | 7,674,366             |
| <b>Change in perpetual trust</b>     | <u>19,442</u>         | <u>45,891</u>         |
| Change in net assets                 | 10,162,405            | 7,720,257             |
| <b>Net assets, beginning of year</b> | <u>146,696,291</u>    | <u>138,976,034</u>    |
| <b>Net assets, end of year</b>       | <u>\$ 156,858,696</u> | <u>\$ 146,696,291</u> |

*See accompanying notes to consolidated financial statements.*

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2010 AND 2009

|                                                                          | 2010           | 2009          |
|--------------------------------------------------------------------------|----------------|---------------|
| <b>Operating activities</b>                                              |                |               |
| Cash received for patient services                                       | \$ 100,395,671 | \$ 96,498,946 |
| Cash paid to/for employees                                               | (51,435,130)   | (52,325,945)  |
| Cash paid to vendors and suppliers                                       | (31,038,827)   | (31,903,105)  |
| Other receipts, net                                                      | 1,064,596      | 1,116,612     |
| Net cash flows from operating activities                                 | 18,986,310     | 13,386,508    |
| <b>Noncapital financing activities</b>                                   |                |               |
| Noncapital contributions                                                 | 614,206        | 631,264       |
| <b>Capital and related financing activities</b>                          |                |               |
| Principal payments on long-term debt                                     | (18,713,964)   | (1,346,057)   |
| Borrowings on long-term debt                                             | 17,024,250     | -0-           |
| Interest paid                                                            | (2,537,653)    | (2,351,460)   |
| Payment on debt issue costs                                              | (221,384)      | -0-           |
| Purchase of capital assets                                               | (5,088,194)    | (6,660,584)   |
| Proceeds from sale of capital assets                                     | 3,800          | 800           |
| Advanced refunding loss                                                  | (174,404)      | -0-           |
| Loss on disposal of capital assets                                       | 317,754        | 204,244       |
| Net cash flows from capital and related financing activities             | (9,389,795)    | (10,153,057)  |
| <b>Investing activities</b>                                              |                |               |
| Investment income                                                        | 3,799,845      | 6,720,963     |
| Other nonoperating revenues (expenses)                                   | (388,515)      | (356,348)     |
| Change in investments                                                    | 4,250,000      | 13,250,000    |
| Change in assets whose use is limited                                    | (2,321,923)    | (3,045,818)   |
| Change in other assets                                                   | 397,542        | (642,730)     |
| Net cash flows from investing activities                                 | 5,736,949      | 15,926,067    |
| Net change in cash and cash equivalents                                  | 15,947,670     | 19,790,782    |
| Cash and cash equivalents, beginning of year                             | 48,475,141     | 28,684,359    |
| Cash and cash equivalents, end of year                                   | \$ 64,422,811  | \$ 48,475,141 |
| <b>Reconciliation of cash and cash equivalents to the balance sheets</b> |                |               |
| Cash and cash equivalents in current assets                              | \$ 38,174,498  | \$ 28,782,628 |
| Cash and cash equivalents in assets whose use is limited                 | 26,248,313     | 19,692,513    |
| Total cash and cash equivalents                                          | \$ 64,422,811  | \$ 48,475,141 |

*See accompanying notes to consolidated financial statements.*

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2010 AND 2009

|                                                                                                            | <u>2010</u>          | <u>2009</u>          |
|------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| <b>Reconciliation of income from operations to net cash and cash equivalents from operating activities</b> |                      |                      |
| Income from operations                                                                                     | \$ 8,331,015         | \$ 3,190,578         |
| Adjustments to reconcile income from operations to net cash flows from operating activities                |                      |                      |
| Depreciation                                                                                               | 8,364,296            | 7,942,847            |
| Amortization                                                                                               | 154,898              | 77,677               |
| Provision for bad debts                                                                                    | 13,222,926           | 12,595,344           |
| Changes in operating assets and liabilities                                                                |                      |                      |
| Patient accounts receivable                                                                                | (14,441,007)         | (11,105,772)         |
| Inventories                                                                                                | (36,309)             | 548,909              |
| Prepaid expenses and other current assets                                                                  | (96,465)             | 173,467              |
| Accounts payable                                                                                           | (60,325)             | (2,540,870)          |
| Accrued payroll and payroll withholdings                                                                   | 1,002,706            | (323,989)            |
| Accrued expenses                                                                                           | (381,841)            | 1,196,103            |
| Estimated third-party payor settlements                                                                    | 3,083,552            | 127,448              |
| Deferred compensation liabilities                                                                          | <u>(157,136)</u>     | <u>1,504,766</u>     |
| Net cash flows from operating activities                                                                   | <u>\$ 18,986,310</u> | <u>\$ 13,386,508</u> |
| <b>Supplemental disclosures of noncash operating and capital and related financing activities</b>          |                      |                      |
| Property and equipment acquired included in accounts payable                                               | \$ 339,025           | \$ 170,721           |

*See accompanying notes to consolidated financial statements.*

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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### **1. NATURE OF OPERATIONS**

Jackson County Schneck Memorial Hospital (d/b/a Schneck Medical Center) (the "Hospital") is a not-for-profit, acute care hospital located in Seymour, Indiana. The Hospital is county owned and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital is organized for the purpose of providing healthcare services to the residents of Jackson County and the surrounding area. The Hospital's primary sources of support are from patient revenues and other ancillary income. Patient revenues include funds received from Medicare, state agencies, insurance companies, and the patients themselves.

Health Development Corporation ("HDC") is a not-for-profit corporation located in Seymour, Indiana. HDC was organized to operate exclusively for the benefit of, to perform the functions of, and to carry out the purposes of the Hospital by recruiting physicians to the surrounding area and by providing medical education programs to the medical and Hospital staff. HDC's primary sources of revenue are from service fees charged to the Hospital.

HDC's consolidated financial statements at December 31, 2010 and 2009, include the accounts of Coordinated Health, LLC (the "Clinic"). The Clinic is wholly-owned by HDC and began operations in 2002. The Clinic was organized to operate exclusively for the benefit of HDC and the purposes for which HDC is organized and operated, including the promotion and support of the health of Jackson County, Indiana residents and residents of surrounding communities. Currently, the Clinic operates four healthcare facilities located in North Vernon, Salem, Scottsburg, and Seymour, Indiana. The Clinic's primary source of revenue is from patient services.

The Jackson County Schneck Memorial Hospital Foundation, Inc. (d/b/a Schneck Medical Center Foundation) (the "Foundation") is a not-for-profit organization located in Seymour, Indiana. The Foundation operates for the benefit of the Hospital. The Foundation's main sources of revenue are earnings on investments, donations received, and rental income.

### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The significant accounting policies followed by the Hospital, HDC, and the Foundation (collectively the "Medical Center") in the preparation of the consolidated financial statements are summarized below:

#### **Reporting Entity and Consolidation Policy**

The accompanying consolidated financial statements include the accounts of the Hospital, HDC, the Clinic, and the Foundation. The Board of County Commissioners of Jackson County appoints the governing Board of Trustees of the

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# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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Hospital, and a financial benefit/burden relationship exists between the Hospital and the Jackson County government. For these reasons, the Hospital is considered a component unit of Jackson County. Similarly, due to their organized purposes, HDC, the Clinic, and the Foundation are considered blended component units of the Hospital. Intercompany transactions and balances have been eliminated in consolidation. The separate audited financial statements of HDC (including the Clinic) and the Foundation may be obtained by contacting the Hospital as follows:

Schneck Medical Center  
411 W. Tipton Street  
P.O. Box 2349  
Seymour, IN 47274

### **Management's Estimates**

Management uses estimates and assumptions in preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if any, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

### **Proprietary Fund Accounting**

The Medical Center utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis of accounting using the economic resources measurement focus. Substantially all revenues and expenses are subject to accrual.

### **Accounting Standards**

Pursuant to Governmental Accounting Standards Board (GASB) standards, the Medical Center 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.

### **Risk Management**

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

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# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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### **Cash and Cash Equivalents**

Cash and cash equivalents as reported on the consolidated balance sheets include petty cash and other cash on hand amounts, checking accounts, and savings accounts that are readily available for use.

Cash and cash equivalents as reported on the consolidated statements of cash flows include investments in highly liquid assets with maturity dates of 90 days or less when purchased.

### **Investments**

Investments include certificates of deposit amounts maturing within one year of the dates of the consolidated balance sheets. Investments are recorded at cost, which approximates market value.

### **Patient Accounts Receivable and Net Patient Service Revenue**

Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including the estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are estimated and accrued in the period the related services are rendered and adjusted in future periods as final settlements are determined.

### **Allowance for Patient Uncollectible Accounts**

The Medical Center estimates an allowance for uncollectible patient accounts receivable based on an evaluation of the aging of the accounts, historical losses, current economic conditions, and other factors unique to their service area and the healthcare industry.

### **Inventories**

Inventories consist of medical supplies, pharmaceuticals, and office supplies and are valued at the lower of cost or market, with cost being determined on the first-in, first-out (FIFO) method.

### **Assets Whose Use is Limited**

Investments in certificates of deposit are reported in the consolidated financial statements at cost, which approximates fair value.

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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Assets whose use is limited include assets set aside by the respective Boards for future capital improvements, over which the Boards retain control and may at their discretion subsequently use for other purposes; assets held by trustees under indenture agreements; assets that have been restricted by donors for specific purposes; and amounts that have been set aside as part of deferred compensation plans.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair market value in the consolidated balance sheets. Investment income or loss, including realized gains and losses on investments and assets whose use is limited, net change in the market value of assets whose use is limited, interest, and dividends, is included in nonoperating revenues when earned.

### **Capital Assets**

The Medical Center's capital assets are reported at historical cost and include expenditures for additions and repairs which substantially increase the useful lives of capital assets. Maintenance, repairs, and minor improvements are expensed as incurred. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land and construction in progress are depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association Guide for Estimated Useful Lives for Fixed Assets.

### **Costs of Borrowing**

Except for capital assets acquired through gifts, contributions, or capital grants, interest costs on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. For the years ended December 31, 2010 and 2009, the Medical Center capitalized interest costs of \$16,971 and \$115,114, respectively.

### **Deferred Costs**

Deferred costs are funds provided to HDC by a local bank that served as trustee on debt borrowed by Jackson Medical Building, LLC ("JMB") when constructing the Medical Office Building ("MOB") adjacent to the Hospital. The amounts are reserved for future construction costs of unfinished leased office space. HDC functions as the current custodian of the funds and releases the liability for the deferred costs when cash is utilized for construction costs of unfinished office space at the original cost per square foot when the MOB was constructed.

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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### **Net Assets**

Net assets of the Medical Center are classified in four 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 Medical Center, including amounts deposited with trustees as required by revenue bond indentures. *Restricted nonexpendable net assets* equal the principal portion of permanent endowments. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt* or *restricted*.

### **Consolidated Statements of Operations and Changes in Net Assets**

For purposed of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenues and expenses. Peripheral and incidental transactions are reported as nonoperating revenues (expenses). Nonoperating revenues (expenses) which are excluded from income from operations include investment income, contributions received, restricted expenditures, and the net change in the market value of assets whose use is limited.

### **Performance Indicator**

The consolidated statements of operations and changes in net assets include *excess revenues*. Consistent with industry practice, changes in net assets which are excluded from *excess revenues* include the change in value of non-expendable perpetual trusts.

### **Charity Care**

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are reported as reductions in net patient service revenue.

### **Advertising and Marketing Costs**

Advertising and marketing costs are charged to operations when incurred. Advertising and marketing costs charged to operations were \$610,244 and \$674,997 for the years ended December 31, 2010 and 2009, respectively.

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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### **Income Taxes**

The Hospital has been granted exemption from taxation as a not-for-profit organization by the Internal Revenue Service under Section 115, and in 2005 was also granted exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code for purposes of maintaining a 403b deferred compensation plan. Therefore, no provision for income taxes has been provided in the consolidated statements of operations and changes in net assets. HDC and the Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Clinic is organized as a single-member Limited Liability Company (LLC). HDC is the sole member of the Clinic. As such, the Clinic is not required to file a separate State or Federal tax return. For tax reporting purposes, all activities of the Clinic are required to be filed with the activities of HDC.

### **Grants and Contributions**

From time to time, the Medical Center receives grants 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.

### **Physician Recruitment Guarantees**

The Financial Accounting Standards Board (FASB) has issued accounting standards which require the Medical Center to report a liability for physician revenue guarantees on its consolidated balance sheets at fair value and amortize that liability and corresponding intangible asset over the income guarantee period. As cash payments are made to the physicians in accordance with the terms of the income guarantees, the Medical Center records a note receivable from each participating physician. These notes are either paid back to the Medical Center or are forgiven by the Medical Center in accordance with the terms of each separate income guarantee agreement. As of December 31, 2010 and 2009, the Medical Center had matching assets and liabilities relating to physician guarantees of \$875,834 and \$1,521,667, respectively.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### Subsequent Events

The Medical Center has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is April 21, 2011.

### Reclassifications

Certain 2009 amounts have been reclassified to provide for consistency with reporting of 2010 information. These reclassifications have no effect on the previously reported change in net assets or net assets.

## 3. DEPOSITS AND INVESTMENTS

Deposits and investments are comprised of the following at December 31, 2010 and 2009:

|                                                      | <u>2010</u>           | <u>2009</u>           |
|------------------------------------------------------|-----------------------|-----------------------|
| Carrying amount                                      |                       |                       |
| Cash and cash equivalents                            | \$ 64,422,811         | \$ 48,475,141         |
| Certificates of deposit                              | 28,166,000            | 32,668,077            |
| Mutual funds                                         | 29,168,125            | 26,569,047            |
| Corporate bonds                                      | 109,897               | 110,341               |
| Perpetual trust                                      | 312,249               | 292,807               |
| Interest receivable                                  | 211,116               | 196,347               |
| Fixed income guaranteed option                       | 615,209               | 665,085               |
| Common stocks                                        | <u>526,042</u>        | <u>535,011</u>        |
| Total                                                | <u>\$ 123,531,449</u> | <u>\$ 109,511,856</u> |
| Included in the consolidated balance sheet captions: |                       |                       |
| Cash and cash equivalents                            | \$ 38,174,498         | \$ 28,782,628         |
| Investments                                          | 2,000,000             | 6,250,000             |
| Assets whose use is limited                          | <u>83,356,951</u>     | <u>74,479,228</u>     |
| Total                                                | <u>\$ 123,531,449</u> | <u>\$ 109,511,856</u> |

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### Custodial Credit Risk - Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the Medical Center's deposits may not be returned to it. The Medical Center does not have a deposit policy for custodial credit risk. Deposits with financial institutions are insured by the Federal Depositary Insurance Corporation ("FDIC") up to FDIC limits. This includes any deposit accounts issued or offered by a qualifying institution.

Investments are carried at fair value or cost which approximates fair value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. As of December 31, 2010 and 2009, the Medical Center had the following investments and maturities, all of which were held in the Medical Center's name by custodial banks or investment companies that are agents of the Medical Center:

| December 31, 2010       |                      |                                  |                  |                  |                 |
|-------------------------|----------------------|----------------------------------|------------------|------------------|-----------------|
|                         | Carrying<br>Amount   | Investment Maturities (in years) |                  |                  |                 |
|                         |                      | Less<br>than 1                   | 1 - 5            | 6 - 10           | More<br>than 10 |
| Certificates of deposit | \$ 28,166,000        | \$ 28,166,000                    | \$ -0-           | \$ -0-           | \$ -0-          |
| Corporate bonds         | 109,897              | -0-                              | 57,619           | 52,278           | -0-             |
| <b>Total</b>            | <b>\$ 28,275,897</b> | <b>\$ 28,166,000</b>             | <b>\$ 57,619</b> | <b>\$ 52,278</b> | <b>\$ -0-</b>   |

| December 31, 2009       |                      |                                  |                   |                  |                 |
|-------------------------|----------------------|----------------------------------|-------------------|------------------|-----------------|
|                         | Carrying<br>Amount   | Investment Maturities (in years) |                   |                  |                 |
|                         |                      | Less<br>than 1                   | 1 - 5             | 6 - 10           | More<br>than 10 |
| Certificates of deposit | \$ 32,668,077        | \$ 32,602,077                    | \$ 66,000         | \$ -0-           | \$ -0-          |
| Corporate bonds         | 110,341              | -0-                              | 60,763            | 49,578           | -0-             |
| <b>Total</b>            | <b>\$ 32,778,418</b> | <b>\$ 32,602,077</b>             | <b>\$ 126,763</b> | <b>\$ 49,578</b> | <b>\$ -0-</b>   |

### Interest Rate Risk

Interest risk rate is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

The Medical Center does have formal investment policies that limit investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates. The Hospital's current investment policy limits investments with maturities of two years or longer to no more than 60 percent of total

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

investments. The Foundation's investment policy prohibits the purchase of fixed income securities with original maturities of more than 10 years, unless the securities are part of a fund portfolio which has an average maturity of not greater than 10 years.

### Credit Risk – Investments

Credit risk is the risk that, in the event of a failure of a financial institution, the Medical Center would not be able to recover deposits, the value of its investments, or collateral securities that are in the possession of an outside party.

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

| <u>Investment Type</u> | <u>Credit Rating<br/>Moody's</u> | <u>Fair Value<br/>2010</u> | <u>Fair Value<br/>2009</u> |
|------------------------|----------------------------------|----------------------------|----------------------------|
| Corporate bonds        | A1                               | \$ 18,122                  | \$ 21,671                  |
| Corporate bonds        | A2                               | 9,550                      | 11,574                     |
| Corporate bonds        | A3                               | 22,911                     | 16,830                     |
| Corporate bonds        | Aaa                              | 2,358                      | -0-                        |
| Corporate bonds        | Aa2                              | 8,871                      | 8,696                      |
| Corporate bonds        | Aa3                              | 18,307                     | 17,877                     |
| Corporate bonds        | Baa1                             | 19,635                     | 16,506                     |
| Corporate bonds        | Baa2                             | 5,883                      | 13,198                     |
| Corporate bonds        | Baa3                             | 4,260                      | 3,989                      |
|                        |                                  | <u>\$ 109,897</u>          | <u>\$ 110,341</u>          |

### Concentration of Credit Risk

The Hospital places no limit on the amount it may invest in any one issuer. The Foundation limits investments in securities of a single issuer to 10 percent of the portfolio's total market value. This limitation does not include U.S. Government Securities. The Medical Center maintains its investments, which at times may exceed federally insured limits. The Medical Center has not experienced any losses in such accounts. The Medical Center believes that it is not exposed to any significant credit risk on investments.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### 4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable reported as current assets at December 31, 2010 and 2009, consist of the following:

|                                          | 2010                 | 2009                 |
|------------------------------------------|----------------------|----------------------|
| Medicare                                 | \$ 7,468,808         | \$ 6,958,050         |
| Medicaid                                 | 2,951,174            | 2,438,189            |
| Blue Cross                               | 4,953,769            | 4,157,299            |
| Other insurance carriers                 | 7,771,487            | 7,167,386            |
| Patients                                 | 15,614,387           | 14,686,808           |
| Total patient accounts receivable        | 38,759,625           | 35,407,732           |
| Less allowance for contractals           | 11,649,665           | 10,963,587           |
| Less allowance for uncollectible amounts | 14,351,049           | 12,903,315           |
| Patient accounts receivable, net         | <u>\$ 12,758,911</u> | <u>\$ 11,540,830</u> |

### 5. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. Assets whose use is limited are reported at market value and include the following at December 31, 2010 and 2009:

#### Investment Summary by Type

|                                                                                 | 2010                 | %              | 2009                 | %              |
|---------------------------------------------------------------------------------|----------------------|----------------|----------------------|----------------|
| Cash and cash equivalents                                                       | \$ 26,248,313        | 31.5 %         | \$ 19,692,513        | 26.4 %         |
| Interest receivable                                                             | 211,116              | 0.3            | 196,347              | 0.3            |
| Certificates of deposit                                                         | 26,166,000           | 31.4           | 26,418,077           | 35.5           |
| Corporate bonds                                                                 | 109,897              | 0.1            | 110,341              | 0.1            |
| Common stocks                                                                   | 526,042              | 0.6            | 535,011              | 0.7            |
| Fixed income guaranteed option                                                  | 615,209              | 0.7            | 665,085              | 0.9            |
| Mutual funds                                                                    | 29,168,125           | 35.0           | 26,569,047           | 35.7           |
| Perpetual trust, held by trustee                                                | 312,249              | 0.4            | 292,807              | 0.4            |
| Total assets whose use is limited                                               | <u>\$ 83,356,951</u> | <u>100.0 %</u> | <u>\$ 74,479,228</u> | <u>100.0 %</u> |
| Less amount required for current obligations                                    | <u>839,097</u>       |                | <u>1,874,374</u>     |                |
| Assets whose use is limited, net of amount required to meet current obligations | <u>\$ 82,517,854</u> |                | <u>\$ 72,604,854</u> |                |

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### Investment Summary by Fund

|                             |                      |                |                      |                |
|-----------------------------|----------------------|----------------|----------------------|----------------|
| Board-Designated Funds      | \$ 72,934,839        | 87.5 %         | \$ 62,085,608        | 83.4 %         |
| Trustee-Held Funds          | 3,419,186            | 4.1            | 4,931,451            | 6.6            |
| Donor-Restricted Funds      | 1,383,600            | 1.7            | 1,685,707            | 2.3            |
| Deferred Compensation Funds | 5,619,326            | 6.7            | 5,776,462            | 7.7            |
| Total                       | <u>\$ 83,356,951</u> | <u>100.0 %</u> | <u>\$ 74,479,228</u> | <u>100.0 %</u> |

### Board-Designated Funds

The Hospital's Board of Trustees approved the funding of depreciation expense to meet the capital asset replacement needs of the facility. Depreciation is funded totally with expenditures for capital items reducing the funded depreciation balance. Board-designated funds also include amounts intended for specific purposes, as established by the Hospital's, HDC's, and Foundation's separate Boards. All income earned by the board-designated accounts is left to accumulate as additions to the funds. Board-designated funds remain under the control of the separate Boards, which may at their discretion later use for other purposes. Therefore, all board-designated funds are included in unrestricted net assets.

### Trustee-Held Funds

The trustee-held funds are restricted for the payments of principal and interest related to certain long-term debt agreements.

### Donor-Restricted Funds

Donor-restricted funds represent donations that have been restricted by donors for specific purposes.

### Deferred Compensation Funds

The deferred compensation funds represent assets that have accumulated under the Medical Center's deferred compensation plan. The Medical Center simply maintains the funds for the participants until they are withdrawn. The Medical Center records a liability equal to the deferred compensation assets.

### Fair Value Measurements and Disclosures

Major classes of assets and liabilities that are measured at fair value are categorized according to a fair value hierarchy that prioritizes the inputs to value techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

Level 1 inputs are readily determinable using unadjusted quoted prices for identical assets or liabilities in active markets. Level 2 inputs are derived from quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets (other than those included in Level 1) which are observable for the asset or liability, either directly or indirectly. Level 3 inputs are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. If the inputs used fall within different levels of the hierarchy, the categorization is based upon the lowest level input that is significant to the fair value measurement.

Fair values of financial instruments at December 31, 2010 follow:

|                                  | Level 1              | Level 2           | Level 3           | Total                |
|----------------------------------|----------------------|-------------------|-------------------|----------------------|
| Corporate bonds                  | \$ -0-               | \$ 109,897        | \$ -0-            | \$ 109,897           |
| Common stocks                    | 526,042              | -0-               | -0-               | 526,042              |
| Mutual funds                     | 29,168,125           | -0-               | -0-               | 29,168,125           |
| Perpetual trust, held by trustee | -0-                  | -0-               | 312,249           | 312,249              |
| Fixed income guaranteed option   | -0-                  | 615,209           | -0-               | 615,209              |
|                                  | <u>\$ 29,694,167</u> | <u>\$ 725,106</u> | <u>\$ 312,249</u> | <u>\$ 30,731,522</u> |

Fair values of financial instruments at December 31, 2009 follow:

|                                  | Level 1              | Level 2           | Level 3           | Total                |
|----------------------------------|----------------------|-------------------|-------------------|----------------------|
| Corporate bonds                  | \$ -0-               | \$ 110,341        | \$ -0-            | \$ 110,341           |
| Common stocks                    | 535,011              | -0-               | -0-               | 535,011              |
| Mutual funds                     | 26,569,047           | -0-               | -0-               | 26,569,047           |
| Perpetual trust, held by trustee | -0-                  | -0-               | 292,807           | 292,807              |
| Fixed income guaranteed option   | -0-                  | 665,085           | -0-               | 665,085              |
|                                  | <u>\$ 27,104,058</u> | <u>\$ 775,426</u> | <u>\$ 292,807</u> | <u>\$ 28,172,291</u> |

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

The following summary sets forth a summary of changes in the fair values of the Medical Center's Level 3 assets for the year ended December 31, 2010:

|                                | Perpetual Trust Held<br>by Trustee |
|--------------------------------|------------------------------------|
| Balance, beginning of the year | \$ 292,807                         |
| Purchase of investments        | -0-                                |
| Redemption                     | -0-                                |
| Change in investment value     | 19,442                             |
| Balance, end of year           | <u>\$ 312,249</u>                  |

The following summary sets forth a summary of changes in the fair values of the Medical Center's Level 3 assets for the year ended December 31, 2009:

|                                | Perpetual Trust Held<br>by Trustee |
|--------------------------------|------------------------------------|
| Balance, beginning of the year | \$ 246,916                         |
| Purchase of investments        | -0-                                |
| Change in investment value     | 45,891                             |
| Balance, end of year           | <u>\$ 292,807</u>                  |

Investments in the Perpetual Trust are recorded at fair value as reported by the trust administrator, which represents the Medical Center's pro rata interest in the net assets of the Trust, substantially all of which are valued on a market-to-market basis.

### 6. LAND

During 1995, the Foundation received a contribution of land from the Hospital in the amount of \$180,000. On June 14, 1995, the Foundation began leasing the land to JMB, at \$100 per month during the period of construction and \$1,500 per month upon completion for a period of 40 years. Pursuant to the land lease agreement, a rate increase of 3 percent was approved and made effective June 1, 2006. The lessee is entitled to renew the lease for seven successive additional terms of five years each. Rental income related to this lease was \$18,540 for both the years ended December 31, 2010 and 2009.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### 7. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2010 and 2009, was as follows:

|                                   | 2010                 |                       |                           |                      |
|-----------------------------------|----------------------|-----------------------|---------------------------|----------------------|
|                                   | Beginning<br>Balance | Additions             | Retirements/<br>Transfers | Ending<br>Balance    |
| Land                              | \$ 5,491,936         | \$ -0-                | \$ 766,239                | \$ 6,258,175         |
| Land improvements                 | 3,849,268            | -0-                   | (4,009)                   | 3,845,259            |
| Leasehold improvements            | 854,508              | -0-                   | -0-                       | 854,508              |
| Buildings                         | 73,092,995           | 411,909               | 675,729                   | 74,180,633           |
| Fixed equipment                   | 5,749,776            | 13,738                | 197,319                   | 5,960,833            |
| Movable equipment                 | 37,252,795           | 2,025,488             | (420,895)                 | 38,857,388           |
| Construction in progress          | 403,479              | 2,976,084             | (2,935,121)               | 444,442              |
| Total historical cost             | 126,694,757          | 5,427,219             | (1,720,738)               | 130,401,238          |
| Less accumulated depreciation for |                      |                       |                           |                      |
| Land improvements                 | (960,921)            | (250,899)             | 972                       | (1,210,848)          |
| Leasehold improvements            | (277,350)            | (121,808)             | -0-                       | (399,158)            |
| Buildings                         | (16,559,201)         | (3,308,613)           | 44,850                    | (19,822,964)         |
| Fixed equipment                   | (4,060,486)          | (320,848)             | 19,622                    | (4,361,712)          |
| Movable equipment                 | (23,095,966)         | (4,362,128)           | 1,333,740                 | (26,124,354)         |
| Total accumulated depreciation    | (44,953,924)         | (8,364,296)           | 1,399,184                 | (51,919,036)         |
| Capital assets, net               | <u>\$ 81,740,833</u> | <u>\$ (2,937,077)</u> | <u>\$ (321,554)</u>       | <u>\$ 78,482,202</u> |

|                                   | 2009                 |                       |                           |                      |
|-----------------------------------|----------------------|-----------------------|---------------------------|----------------------|
|                                   | Beginning<br>Balance | Additions             | Retirements/<br>Transfers | Ending<br>Balance    |
| Land                              | \$ 5,548,744         | \$ 61,853             | \$ (118,661)              | \$ 5,491,936         |
| Land improvements                 | 3,872,112            | 18,530                | (41,374)                  | 3,849,268            |
| Leasehold improvements            | 501,814              | 7,084                 | 345,610                   | 854,508              |
| Buildings                         | 67,666,856           | 83,409                | 5,342,730                 | 73,092,995           |
| Fixed equipment                   | 5,625,498            | 78,523                | 45,755                    | 5,749,776            |
| Movable equipment                 | 35,698,333           | 2,450,399             | (895,937)                 | 37,252,795           |
| Construction in progress          | 3,603,254            | 4,131,507             | (7,331,282)               | 403,479              |
| Total historical cost             | 122,516,611          | 6,831,305             | (2,653,159)               | 126,694,757          |
| Less accumulated depreciation for |                      |                       |                           |                      |
| Land improvements                 | (994,224)            | (247,213)             | 280,516                   | (960,921)            |
| Leasehold improvements            | (167,298)            | (110,052)             | -0-                       | (277,350)            |
| Buildings                         | (13,969,325)         | (2,943,099)           | 353,223                   | (16,559,201)         |
| Fixed equipment                   | (3,974,853)          | (293,450)             | 207,817                   | (4,060,486)          |
| Movable equipment                 | (20,353,492)         | (4,349,033)           | 1,606,559                 | (23,095,966)         |
| Total accumulated depreciation    | (39,459,192)         | (7,942,847)           | 2,448,115                 | (44,953,924)         |
| Capital assets, net               | <u>\$ 83,057,419</u> | <u>\$ (1,111,542)</u> | <u>\$ (205,044)</u>       | <u>\$ 81,740,833</u> |

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### 8. OTHER ASSETS

At December 31, 2010 and 2009, other assets consist of the following:

|                                       | 2010                | 2009                |
|---------------------------------------|---------------------|---------------------|
| Prepaid pension costs                 | \$ 2,287,141        | \$ 2,896,664        |
| Physician notes receivable            | 1,466,777           | 1,464,540           |
| Notes receivable                      | 41,676              | 56,475              |
| Investment in managed care company    | 755,000             | 755,000             |
| Investment in RCG Columbus, LLC       | 974,900             | 974,900             |
| Investment in JMB                     | 267,774             | 211,638             |
| Investment in risk retention company  | 335,311             | 335,311             |
| Bond issue costs, net                 | 752,416             | 810,118             |
| Other                                 | 510,686             | 218,091             |
| Less: current portion of other assets | <u>(303,745)</u>    | <u>(601,516)</u>    |
| Other assets, net of current portion  | <u>\$ 7,087,936</u> | <u>\$ 7,121,221</u> |

Physician notes receivable are in varying amounts maturing through October 2015. If the physicians meet the period of service requirement, the Medical Center will forgive these notes. If the physicians do not meet the period-of-service requirement, the notes are immediately due in full. Interest rates are prime rate + 1 to prime rate + 2 percent (4.25 and 5.25 percent, respectively, at December 31, 2010).

The Medical Center is a partial owner of a healthcare managed care company. The Medical Center has a one-sixth voting interest in the managed care company and accounts for its investment using the cost method.

In June of 2000, the Medical Center made a \$974,900 contribution to purchase a 12.25 percent ownership interest in RCG Columbus, LLC ("RCG"). RCG provides renal care to patients. The Medical Center's investment in RCG is being accounted for under the cost method.

The Medical Center made a \$200,000 capital contribution to purchase an ownership interest in JMB. The Medical Center owns a 20 percent interest in JMB and accounts for this investment under the equity method of reporting.

The Medical Center is a less than 20 percent owner of Indiana Healthcare Reciprocal Risk Retention Group, a risk retention company created to purchase professional liability and general liability insurance for its members. The Medical Center accounts for this investment using the cost method.

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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Bond issue costs are being amortized over the lives of the bonds on the straight-line method, which approximates the effective interest method.

### **9. COMPENSATED ABSENCES**

The Medical Center provides a paid time off (PTO) policy to employees for vacation, sick time, personal days, and holidays. Upon employment, full and part-time employees who are budgeted, scheduled, and work at least 37.5 hours per pay period accrue PTO from the date of hire. After completion of 6 months of service as a benefit eligible employee, PTO may be used with pay for the total amount accrued.

The rate at which full-time employees earn PTO and the maximum number of hours that may be banked are as follows:

| <u>Employee Type</u> | <u>Length of Service</u> | <u>PTO earned for<br/>each hour paid</u> | <u>Maximum<br/>PTO bank</u> |
|----------------------|--------------------------|------------------------------------------|-----------------------------|
| General              | 0 - 2 years              | 0.0885                                   | 368 hours                   |
| General              | 2 - 10 years             | 0.1077                                   | 448 hours                   |
| General              | 10 or more years         | 0.1270                                   | 528 hours                   |
| Directors            | 0 - 2 years              | 0.1077                                   | 448 hours                   |
| Directors            | 2 or more years          | 0.1270                                   | 528 hours                   |
| Vice Presidents      | Upon hire                | 0.1462                                   | 608 hours                   |

PTO days are accrued when incurred. The PTO accrual at December 31, 2010 and 2009 was \$3,336,531 and \$3,047,120, respectively and is reported in Accrued Expenses in the consolidated financial statements.

### **10. EMPLOYEE HEALTH BENEFIT PLAN**

The Medical Center operates a self-funded health plan covering substantially all employees. The Medical Center has an annual stop loss limit on the plan of \$80,000 per insured per year and an aggregate stop loss limit of approximately \$6,200,000. Claim expenditures and liabilities 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. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of pay out, and other economic and social factors. The accrued liability for claims liabilities is recorded in Accrued Expenses on the consolidated balance sheets.

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**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2010 AND 2009**

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Changes in the balance of claims liabilities during the years ended December 31, 2010 and 2009, were as follows:

|                                          | <u>2010</u>         | <u>2009</u>         |
|------------------------------------------|---------------------|---------------------|
| Accrued liability, beginning of year     | \$ 1,560,511        | \$ 1,056,632        |
| Incurred claims and changes in estimates | 7,173,022           | 9,864,264           |
| Claim payments                           | <u>(7,485,593)</u>  | <u>(9,360,385)</u>  |
| Accrued liability, end of year           | <u>\$ 1,247,940</u> | <u>\$ 1,560,511</u> |

**11. DEFINED BENEFIT PENSION PLAN**

Plan Description

The Medical Center sponsors a single-employer, defined benefit pension plan covering all employees that are at least twenty-one years old and have at least one year of eligibility service. Benefit provisions are established or may be amended at any time by the action of the Plan's Board of Trustees. The Medical Center functions as the plan administrator of the defined benefit pension plan, as authorized by IC 16-22-3-11. A publicly available financial report that includes the defined benefit pension plan's financial statements and required supplementary information may be obtained by contacting:

Schneck Medical Center  
P.O. Box 2349  
Seymour, IN 47274  
Ph. (812) 522-0118

Funding Policy

No contributions from active plan members are required or permitted. The Internal Revenue Service has determined that the plan is a government plan which is not subject to ERISA minimum funding requirements.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### Annual Pension Cost and Net Pension Obligation

The Medical Center's annual pension cost and net pension obligation for the years ended December 31, 2010 and 2009, are as follows:

|                                                  | <u>2010</u>           | <u>2009</u>           |
|--------------------------------------------------|-----------------------|-----------------------|
| Annual required contribution                     | \$ 2,059,451          | \$ 875,105            |
| Interest on net pension obligation               | (161,123)             | (160,739)             |
| Adjustment to annual required contribution       | <u>181,119</u>        | <u>180,686</u>        |
| Annual pension cost                              | 2,079,447             | 895,052               |
| Interest on employer contributions               | (44,030)              | (15,628)              |
| Contributions made                               | <u>(1,425,894)</u>    | <u>(1,545,796)</u>    |
| (Increase) decrease in net pension asset         | 609,523               | (666,372)             |
| Net pension (asset)/liability, beginning of year | <u>(2,896,664)</u>    | <u>(2,230,292)</u>    |
| Net pension (asset)/liability, end of year       | <u>\$ (2,287,141)</u> | <u>\$ (2,896,664)</u> |

The annual required contribution for the current year was determined as part of the May 1, 2010, actuarial valuation using the Unit Credit Cost Method, replacing the Entry Age Normal Cost Method used in the May 1, 2009 actuarial valuation. The actuarial assumptions included (a) 8.0 percent investment rate of return (net of administrative expenses) and (b) projected salary increases of 3.75 percent (2.75 percent due to inflation and 1 percent due to merit/seniority) and (c) an inflation rate of 4.0 percent. The actuarial value of assets was determined using the market value of assets. The unfunded actuarial accrued liability is being amortized on a level dollar basis. The amortization period is 30 years from the valuation date.

| <u>Three-Year Trend Information</u> |                                |                                          |                              |
|-------------------------------------|--------------------------------|------------------------------------------|------------------------------|
| <u>Fiscal Year<br/>Ending</u>       | <u>Annual<br/>Pension Cost</u> | <u>Percentage of<br/>APC Contributed</u> | <u>Net Pension<br/>Asset</u> |
| 12/31/2008                          | \$ 509,609                     | 43.4%                                    | \$ (2,230,292)               |
| 12/31/2009                          | 895,052                        | 172.7%                                   | (2,896,664)                  |
| 12/31/2010                          | 2,079,447                      | 68.6%                                    | (2,287,141)                  |

During 2010, the Medical Center froze the plan, no longer allowing new participants, and discontinuing the accrual of benefits for additional years of service for active participants.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Required supplementary information relating to the defined benefit pension plan is as follows:

| Plan Year Ending                                                                                | 12/31/10     | 12/31/09     | 12/31/08     |
|-------------------------------------------------------------------------------------------------|--------------|--------------|--------------|
| Actuarial Valuation Date                                                                        | 5/1/2010     | 5/1/2009     | 5/1/2008     |
| Actuarial Value of Plan Assets                                                                  | \$25,200,522 | \$17,746,521 | \$28,512,816 |
| Actuarial Accrued Liability                                                                     | \$23,878,228 | \$28,558,566 | \$28,512,816 |
| Total Unfunded Actuarial Liability                                                              | \$0          | \$10,812,035 | \$0          |
| Actuarial Value of Assets as a Percentage of the<br>Actuarial Accrued Liability- "Funded Ratio" | 105.5%       | 62.1%        | 100.0%       |
| Annual Covered Payroll                                                                          | \$33,404,583 | \$31,029,799 | \$24,300,050 |
| Ratio of Unfunded Actuarial Liability<br>to Annual Covered Payroll                              | 0.0%         | 34.8%        | 0.0%         |

## 12. LONG-TERM DEBT

At December 31, 2010 and 2009, the Medical Center was obligated for long-term debt agreements as follows:

|                                                                                                                                                                                                                                                                                                                         | 2010       | 2009          |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|---------------|
| Indiana Health Facility Financing Authority Series 1998 Revenue Bonds dated January 1998, payable in annual principal installments commencing February 1999 through February 2022, in amounts ranging from \$300,000 to \$1,880,000. Serial fixed interest rates ranging from 5.0% to 5.25%. Secured by gross revenues. | \$ 10,000  | \$ 18,350,000 |
| Indiana Financing Authority Series 2010 Revenue Bonds dated December 2010, payable in annual principal installments commencing February 2011 through February 2022, in amounts ranging from \$325,000 to \$1,765,000. Serial fixed interest rates ranging from 3.0% to 5.0%. Secured by gross revenues.                 | 16,280,000 | -0-           |

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |                      |                      |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| Indiana Health and Educational Facility Financing Authority ("IHEFFA") Series 2006A Revenue Bonds dated May 2006, payable in annual principal installments commencing February 2023 through February 2036, in amounts ranging from \$750,000 to \$1,465,000. Fixed interest rate of 5.0% on \$770,000 and 5.25% on \$14,230,000. Secured by gross revenues.                                                                                                                                                                                                                                                                                                                                                                                                                   | 15,000,000           | 15,000,000           |
| IHEFFA Series 2006B Revenue Bonds dated May 2006, payable in annual principal installments commencing February 2007 through February 2036 in amounts ranging from \$150,000 to \$1,610,000. In October 2009, bonds were converted to long-mode and re-issued to Branch Bank and Trust ("BB&T") who will hold the bonds through October 2014. During this period, variable interest rate equal to the greater of 1.14% plus .68% of the 30-day LIBOR, or 2.06% (2.06% at December 31, 2010). In October 2014, BB&T may exercise a put option on the bonds, or refinance the remaining principal with the Medical Center. If the put option is exercised by BB&T, the Medical Center may re-issue the bonds with another bank or in the bond market. Secured by gross revenues. | 19,395,000           | 19,545,000           |
| Note payable to bank dated February 2010, due December 2014; monthly payments of \$8,483, including interest beginning February 2010; fixed interest rate of 4% per annum. Secured by equipment.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 370,989              | -0-                  |
| Note payable to bank dated July 2005, due July 2010; monthly payments of \$18,063, including interest beginning August 2005; fixed interest rate of 4.17% per annum. Secured by equipment.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | -0-                  | 124,681              |
| Note payable to bank dated August 2008, due July 2011; monthly payments of \$1,782, including interest beginning August 2008; fixed interest rate of 4.7% per annum. Secured by equipment.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | 12,277               | 32,549               |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | 51,068,266           | 53,052,230           |
| Unamortized bond premium                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | 541,368              | 259,237              |
| Bond refunding loss                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | (1,038,376)          | (719,776)            |
| Less unamortized bond discounts                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | -0-                  | (148,085)            |
| Less current portion                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | (528,599)            | (1,229,912)          |
| Long-term debt, net of current portion                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | <u>\$ 50,042,659</u> | <u>\$ 51,213,694</u> |

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Long-term debt activity for the years ended December 31, 2010 and 2009 was as follows:

|                             | 2010                 |                      |                        |                      |                   |
|-----------------------------|----------------------|----------------------|------------------------|----------------------|-------------------|
|                             | Beginning Balance    | Increases            | Decreases              | Ending Balance       | Current Portion   |
| Revenue bonds, series 1998  | \$ 18,350,000        | \$ -0-               | \$ (18,340,000)        | \$ 10,000            | \$ 10,000         |
| Revenue bonds, series 2006A | 15,000,000           | -0-                  | -0-                    | 15,000,000           | -0-               |
| Revenue bonds, series 2006B | 19,545,000           | -0-                  | (150,000)              | 19,395,000           | 150,000           |
| Revenue bonds, series 2010  | -0-                  | 16,280,000           | -0-                    | 16,280,000           | 325,000           |
| Note payable to bank        | -0-                  | 450,000              | (79,011)               | 370,989              | 88,385            |
| Note payable to bank        | 124,681              | -0-                  | (124,681)              | -0-                  | -0-               |
| Note payable                | 32,549               | -0-                  | (20,272)               | 12,277               | 12,277            |
| Bond premiums               | 259,237              | 294,250              | (12,119)               | 541,368              | 36,274            |
| Bond refunding loss         | (719,776)            | (1,042,265)          | 723,665                | (1,038,376)          | (93,337)          |
| Bonds discounts             | (148,085)            | -0-                  | 148,085                | -0-                  | -0-               |
| Total long-term debt        | <u>\$ 52,443,606</u> | <u>\$ 15,981,985</u> | <u>\$ (17,854,333)</u> | <u>\$ 50,571,258</u> | <u>\$ 528,599</u> |

|                             | 2009                 |               |                       |                      |                     |
|-----------------------------|----------------------|---------------|-----------------------|----------------------|---------------------|
|                             | Beginning Balance    | Increases     | Decreases             | Ending Balance       | Current Portion     |
| Revenue bonds, series 1998  | \$ 19,320,000        | \$ -0-        | \$ (970,000)          | \$ 18,350,000        | \$ 1,035,000        |
| Revenue bonds, series 2006A | 15,000,000           | -0-           | -0-                   | 15,000,000           | -0-                 |
| Revenue bonds, series 2006B | 19,695,000           | -0-           | (150,000)             | 19,545,000           | 150,000             |
| Note payable to bank        | 331,404              | -0-           | (206,723)             | 124,681              | 124,681             |
| Note payable                | 51,883               | -0-           | (19,334)              | 32,549               | 20,272              |
| Bond premiums               | 269,160              | -0-           | (9,923)               | 259,237              | 9,923               |
| Bond refunding loss         | (815,243)            | -0-           | 95,467                | (719,776)            | (92,891)            |
| Bond discounts              | (165,409)            | -0-           | 17,324                | (148,085)            | (17,073)            |
| Total long-term debt        | <u>\$ 53,686,795</u> | <u>\$ -0-</u> | <u>\$ (1,243,189)</u> | <u>\$ 52,443,606</u> | <u>\$ 1,229,912</u> |

Debt service requirements on long-term debt at December 31, 2010, are as follows:

| <u>Year Ending December 31,</u> | <u>Principal</u>     | <u>Interest</u>      |
|---------------------------------|----------------------|----------------------|
| 2011                            | \$ 528,599           | \$ 1,318,521         |
| 2012                            | 1,379,933            | 1,920,953            |
| 2013                            | 1,418,775            | 1,878,171            |
| 2014                            | 1,472,707            | 1,821,912            |
| 2015                            | 1,422,937            | 1,765,432            |
| 2016 - 2020                     | 8,114,685            | 7,789,835            |
| 2021 - 2025                     | 8,893,153            | 5,712,622            |
| 2026 - 2030                     | 10,774,615           | 3,911,264            |
| 2031 - 2035                     | 13,489,615           | 1,789,419            |
| 2036                            | 3,076,239            | 55,039               |
| Total                           | <u>\$ 50,571,258</u> | <u>\$ 27,963,168</u> |

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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During the year ended December 31, 2010, an advanced refunding of the Medical Center's Series 1998 Revenue Bonds was performed through the Medical Center's issuance of \$16,280,000 in Series 2010 Revenue Bonds. This refunding resulted in the Medical Center recognizing a refunding loss totaling \$1,042,265. The refunding loss serves as a contra-liability to long-term debt and is being amortized to interest expense using the effective interest method over the life of the new bonds.

The Medical Center's debt agreements contain various restrictive covenants, including covenants related to days cash on hand ratio, debt service coverage ratio, debt to capitalization ratio, and audited financial statement submission requirements.

### **13. DEFERRED COMPENSATION PLAN**

The Medical Center offers its employees deferred compensation plans in accordance with Internal Revenue Code Sections 457 and 403(b). The plans, available to all Medical Center employees, permit them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plans, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the Medical Center (without being restricted to the provisions of benefits under the plans), subject only to the claims of the Medical Center's general creditors. Participants' rights under the plans are equal to those of general creditors of the Medical Center in an amount equal to the fair market value of the deferred account for each participant. The Medical Center believes that it is unlikely that it will use the assets to satisfy the claims of general creditors in the future. The deferred compensation assets and related liabilities under these plans are reported in the Consolidated Balance Sheets as Assets Whose Use is Limited and Deferred Compensation Liabilities, respectively. The amounts recognized as both deferred compensation assets and liabilities were \$5,619,326 and \$5,776,462 for the years ended December 31, 2010 and 2009, respectively.

In 2010, the Medical Center amended its 403(b) defined contribution plan to allow for employer discretionary and matching contributions. For the years ended December 31, 2010 and 2009, the Medical Center recognized \$526,000 and \$0, respectively, in expense related to the 403(b) plan.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### 14. DONOR-DESIGNATED AND NONEXPENDABLE RESTRICTED NET ASSETS

Donor-designated restricted net assets are donor-restricted for a specific use or by the passage of time. Nonexpendable restricted net assets include a perpetual trust. Donor-designated and nonexpendable restricted net assets include the following at December 31, 2010 and 2009:

|                                                | 2010                  | 2009                  |
|------------------------------------------------|-----------------------|-----------------------|
| <b>Donor-designated restricted net assets</b>  |                       |                       |
| Dr. Bud Fund                                   | \$ 416,934            | \$ 391,302            |
| Medical Technology Fund                        | 4,930                 | 4,909                 |
| Women's Center Fund                            | 475                   | 200                   |
| <br>Community Service Fund                     | <br>-0-               | <br>2,406             |
| Cancer Fund                                    | 398,594               | 485,847               |
| Hospice Fund                                   | 152,061               | 120,957               |
| <br>George H. James Scholarship Fund           | <br>17,215            | <br>29,215            |
| EPIC Fund                                      | 75,910                | 23,582                |
| Employee Humanitarian Fund                     | 5,232                 | 1,446                 |
| Anna Gaiser Fund                               | -0-                   | 333,036               |
|                                                | <u>          </u>     | <u>          </u>     |
| Total donor-designated restricted net assets   | <u>\$ 1,071,351</u>   | <u>\$ 1,392,900</u>   |
| <br><b>Nonexpendable restricted net assets</b> |                       |                       |
| <br>Perpetual trust, held by trustee           | <br><u>\$ 312,249</u> | <br><u>\$ 292,807</u> |

#### Dr. Bud Fund

The Dr. Bud Fund was established to provide scholarships to area students seeking to pursue careers in healthcare. Scholarships are awarded based on the recommendations of the Dr. Bud Fund Scholarship Committee.

#### EPIC Fund

The EPIC (Employee Partners Invested in Caring) Fund was established to receive financial support from its members for special projects and programs recommended by those members.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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### Anna Gaiser Fund

The Anna Gaiser Fund was established to provide care to patients who did not otherwise qualify for additional amounts of subsidies from varying sources. All income earned by this fund is left to accumulate as an addition of the fund until used for the specified purpose of the fund.

### Perpetual Trust, Held by Trustee

The perpetual trust, held by trustee represents a donation that is held in a separate trust account. The donation is to be held in perpetuity. The Hospital has no control over the investment strategy of the trust, and will not receive any payments from the trust's principal. However, the Hospital is entitled to receive 20 percent of the trust's net income each year. All of the Hospital's portion of income earned by this trust is unrestricted and may be used at the Hospital's Board of Trustee's discretion.

## 15. NET PATIENT SERVICE REVENUE

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

- **Medicare**. The Medical Center is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Medical Center is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicare outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. The Hospital's classification of patients under the Medicare program and the appropriateness of their admissions are subject to an independent review by a peer review organization under contract with the Hospital. As of December 31, 2010, the Hospital's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2006.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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- **Medicaid.** The Medical Center is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Medical Center is reimbursed for Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. There is no cost settlement for either of the inpatient or outpatient programs. For the years ended December 31, 2010 and 2009, the Medical Center received and recorded in net patient service revenue \$2,793,119 and \$2,878,190, respectively, relating to net Medicaid Disproportionate Share Hospital ("DSH") payments and Indiana Medicaid Municipal Hospital Upper Payment Limit ("UPL") adjustments.

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. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Medical Center believes that it is in compliance with all applicable laws and regulations.

The Medical Center has also entered into preferred provider agreements with certain commercial insurance carriers. The basis for payment to the Medical Center under these agreements includes discounts from established charges, fee schedules, as well as inpatient DRG reimbursement methodologies.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

For the years ended December 31, 2010 and 2009, net patient service revenue was as follows:

|                                        | <u>2010</u>              | <u>2009</u>              |
|----------------------------------------|--------------------------|--------------------------|
| Gross patient service revenue          |                          |                          |
| Inpatient routine services             | \$ 8,913,565             | \$ 8,548,697             |
| Inpatient ancillary services           | 50,432,292               | 47,070,108               |
| Outpatient ancillary services          | <u>177,454,063</u>       | <u>170,521,633</u>       |
| Total gross patient service revenue    | 236,799,920              | 226,140,438              |
| Deductions from revenue                |                          |                          |
| Contractual allowances                 | 123,784,250              | 117,837,071              |
| Charity care                           | 4,055,663                | 3,704,287                |
| Bad debts                              | 13,222,926               | 12,595,344               |
| Medicaid DSH and UPL payments received | <u>(2,793,119)</u>       | <u>(2,878,190)</u>       |
| Total deductions from revenue          | <u>138,269,720</u>       | <u>131,258,512</u>       |
| <br>Total net patient service revenue  | <br><u>\$ 98,530,200</u> | <br><u>\$ 94,881,926</u> |

GASB requires bad debts to be reported as a deduction from gross patient service revenue while FASB requires bad debts to be reported as an operating expense.

### 16. NONOPERATING REVENUES

For the years ended December 31, 2010 and 2009, nonoperating revenues (expenses) were as follows:

|                                    | <u>2010</u>             | <u>2009</u>             |
|------------------------------------|-------------------------|-------------------------|
| Investment income                  | \$ 3,780,403            | \$ 6,675,072            |
| Interest expense                   | (2,194,146)             | (2,466,200)             |
| Loss on disposal of capital assets | (317,754)               | (204,244)               |
| Contributions and grants           | 614,206                 | 631,264                 |
| Miscellaneous                      | <u>(70,761)</u>         | <u>(152,104)</u>        |
| <br>Total nonoperating revenues    | <br><u>\$ 1,811,948</u> | <br><u>\$ 4,483,788</u> |

GASB requires interest expense to be reported as nonoperating expense while FASB requires interest expense to be reported as an operating expense.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### 17. PROFESSIONAL LIABILITY INSURANCE

The Indiana Medical Malpractice Act, IC 34-18, provides a maximum recovery of \$250,000 for an occurrence of malpractice and \$1,250,000 for an injury or death of a patient due to an act of malpractice. The Act requires physicians to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$750,000 in the annual aggregate and hospitals to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$5,000,000 for hospitals with fewer than 100 occupied beds. The Act also requires the Medical Center to pay a surcharge to the State Patient's Compensation Fund. This fund may be used to pay medical malpractice claims in excess of the annual aggregate amount noted above, under certain terms and conditions.

The Medical Center maintains professional liability insurance through a multiprovider reciprocal risk retention group (the "Group"), in which premiums are accrued based on the Group's experience to date. This provides protection from liability in amounts not to exceed as follows:

|                                            | <u>2010</u>          | <u>2009</u>          |
|--------------------------------------------|----------------------|----------------------|
| Medical Center per occurrence              | <u>\$ 250,000</u>    | <u>\$ 250,000</u>    |
| Medical Center aggregate                   | <u>\$ 5,000,000</u>  | <u>\$ 5,000,000</u>  |
| Group umbrella aggregate                   | \$ 10,000,000        | \$ 10,000,000        |
| Group first additional umbrella aggregate  | 10,000,000           | 10,000,000           |
| Group second additional umbrella aggregate | <u>10,000,000</u>    | <u>10,000,000</u>    |
| Total Group umbrella aggregate             | <u>\$ 30,000,000</u> | <u>\$ 30,000,000</u> |

Liabilities for incurred but not reported losses at December 31, 2010 and 2009 are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Medical Center's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Medical Center intends to continue carrying such insurance.

**JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL  
AND AFFILIATED ORGANIZATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2010 AND 2009

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**18. RELATED PARTY TRANSACTIONS**

Jackson Medical Building, LLC

HDC has a 20 percent ownership interest in Jackson Medical Building, LLC. HDC has entered into two noncancelable operating leases with Jackson Medical Building, LLC through 2011. HDC is leasing space in the medical building for future physicians. HDC recognized total rent expense of \$324,574 and \$309,890 for the years ended December 31, 2010 and 2009, respectively.

The following is a schedule of future minimal rental payments required under the operating leases as of December 31, 2010:

| <u>Year ending December 31,</u> | <u>Amount</u>     |
|---------------------------------|-------------------|
| 2011                            | <u>\$ 107,135</u> |

Jackson County Bank

During 2010, the Medical Center's Chief Financial Officer began serving on the Board of Directors for Jackson County Bank ("JCB"). At December 31, 2010, the Medical Center had deposits of \$19,273,294 and notes payable of \$370,989 with JCB. For the year ended December 31, 2010, the Medical Center recognized \$340,129 in interest income and \$15,841 in interest expense related to deposits and notes payable, respectively, with JCB.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

### 19. CONCENTRATIONS OF CREDIT RISK

The Medical Center grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements. The mix of gross revenues and receivables from patients and third-party payors at December 31, 2010 and 2009, was as follows:

|                          | 2010         |              | 2009         |              |
|--------------------------|--------------|--------------|--------------|--------------|
|                          | Revenues     | Receivables  | Revenues     | Receivables  |
| Medicare                 | 38 %         | 20 %         | 39 %         | 20 %         |
| Medicaid                 | 12           | 8            | 11           | 7            |
| Blue Cross               | 24           | 12           | 23           | 12           |
| SIHO                     | 9            | 7            | 10           | 9            |
| Other third-party payors | 11           | 12           | 11           | 11           |
| Patients                 | 6            | 41           | 6            | 41           |
|                          | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> |

The Medical Center maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Medical Center has not experienced any losses on such accounts. The Medical Center believes it is not exposed to any significant credit risk on cash.

### 20. OPERATING LEASES

The Medical Center leases certain building space under noncancelable operating leases expiring in various years through 2014. Minimum future rental payments under these noncancelable operating leases, including payments for the related party leases in Note 18, as of December 31, 2010, are as follows:

| <u>Year Ending December 31,</u> | <u>Amount</u>     |
|---------------------------------|-------------------|
| 2011                            | \$ 198,610        |
| 2012                            | 100,475           |
| 2013                            | 100,475           |
| 2014                            | <u>9,000</u>      |
| Total minimum payments          | <u>\$ 408,560</u> |

The Medical Center incurred \$982,694 and \$1,025,461 in total rent expense for the years ended December 31, 2010 and 2009, respectively, under cancelable and noncancelable operating leases.

# **JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009**

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### **21. FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

#### Cash and Cash Equivalents

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates its fair value based on the short maturities of those items.

#### Investments

The carrying amount reported in the consolidated balance sheets for investments approximates its fair value based on the short maturities of those items.

#### Assets Whose Use is Limited

These assets are reported in the consolidated balance sheets at fair value. The fair value amounts are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

#### Accounts Payable, Accrued Payroll and Payroll Withholdings, and Accrued Expenses

The carrying amounts reported in the consolidated balance sheets for accounts payable, accrued payroll and payroll withholdings, and accrued expenses approximate their fair value based on the short maturities of those items.

#### Estimated Third-Party Payor Settlements

The carrying amount reported in the consolidated balance sheets for estimated third-party payor settlements approximates its fair value because they are expected to be settled in the near future.

#### Long-Term Debt

The carrying amounts reported in the consolidated balance sheets for long-term debt at December 31, 2010 and 2009 is \$50,571,258 and \$52,443,606, respectively. The fair value of long-term debt at December 31, 2010 and 2009 is approximately \$52,113,202 and \$53,898,196, respectively.

# JACKSON COUNTY SCHNECK MEMORIAL HOSPITAL AND AFFILIATED ORGANIZATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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### Deferred Compensation Liabilities and Deferred Costs

The carrying amounts reported in the consolidated balance sheets for deferred compensation liabilities and deferred costs approximate their fair value. The fair value amounts are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

## 22. CONTINGENCIES

There are a variety of legal proceedings and claims by others against the Medical Center in a variety of matters arising out of the conduct of the Medical Center's business. The ultimate resolution of such claims would not, in the opinion of management, have a material adverse effect on the consolidated financial statements.

## 23. COMMITMENTS

As of December 31, 2010, the Medical Center has construction and renovation project commitments as follows:

| <u>Project</u>                                                             | <u>Expected Date<br/>of Completion</u> | <u>Estimated Total<br/>Cost of Project</u> | <u>Costs Incurred as of<br/>December 31, 2010</u> |
|----------------------------------------------------------------------------|----------------------------------------|--------------------------------------------|---------------------------------------------------|
| Citrix Xenapp System                                                       | 2011                                   | \$ 200,000                                 | \$ 43,684                                         |
| Meditech Scanning/Archiving                                                | 2011                                   | 225,000                                    | 21,715                                            |
| Replacement of Air Handlers                                                | 2011                                   | 165,000                                    | 147,436                                           |
| Demolition of 401 S Poplar for lot<br>resurfacing for employee parking lot | 2011                                   | 32,000                                     | 2,488                                             |
| Clinic - New Jennings Co. Location                                         | 2011                                   | 341,000                                    | 13,509                                            |
| All other projects                                                         | 2011                                   | 225,000                                    | 215,610                                           |
|                                                                            |                                        | <u>\$ 1,188,000</u>                        | <u>\$ 444,442</u>                                 |

## 24. SUBSEQUENT EVENT

As of December 31, 2010, the Medical Center had a 20 percent ownership interest in Jackson Medical Building, LLC. Beginning in 2011, the Medical Center purchased additional ownership shares, which increased the ownership percentage to 95 percent by April 2011.