

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

**AUDIT REPORT
OF**

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

January 1, 2011 to December 31, 2011



FILED
08/27/2012

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HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Chief Executive Officer	Gary L. Kendrick John Rossfeld (Interim) Dave Bixler	01-01-11 to 07-25-11 07-26-11 to 08-31-12 09-01-12 to 12-31-12
Chief Financial Officer	Brad Hardcastle Deborah White (Interim) Catherine E. Keck (Interim)	01-01-11 to 04-26-12 04-27-12 to 06-18-12 06-19-12 to 12-31-12
Chairman of the Board of Governors	Kenneth Parsons	01-01-11 to 12-31-12
President of the Board of County Commissioners	Anthony B. Wichman	01-01-11 to 12-31-12



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

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INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF THE DAVIESS COMMUNITY HOSPITAL, DAVIESS COUNTY, INDIANA

We have audited the accompanying basic financial statements of the business-type activities of the Daviess Community Hospital (Hospital) a component unit of Daviess County, as of and for the year ended December 31, 2011, as listed in the Table of Contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Hospital as of December 31, 2011, and the respective changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

STATE BOARD OF ACCOUNTS

August 7, 2012

Management's Discussion and Analysis

Our discussion and analysis of Daviess Community Hospital's (the Hospital) financial performance provides an overview of the Hospital's financial statements for the fiscal year ended December 31, 2011. Please read it in conjunction with the Hospital's financial statements and accompanying notes to the financial statements. Unless otherwise stated, amounts are presented in millions.

Using This Annual Report

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

- In the ***Management's Discussion and Analysis*** section of this report, the Hospital discusses various components of the annual report and provides an analysis of the current financial statement information.

The ***Basic Financial Statement*** section of this report includes a series of financial statements which provide information about the activities of the Hospital as a whole. The Statement of Net Assets reveals the assets and liabilities of the Hospital on December 31, 2011 while the Statement of Revenues, Expenses and Changes in Net Assets summarize the change in cash and cash equivalents as a result of the financial activity during the year. The Notes to the Financial Statements disclose additional information addressed within the body of the financial statements. This does not include the cash flow statement, which is part of the "Basic Financial Statement" section of the report.

Financial Highlights

- The Hospital's net assets declined \$3.0 million as a result of this year's operations.
- The Hospital's net operating revenues of \$45.5 million increased by \$1.0 million or 2.2% from prior year. Gross revenue for inpatients increased \$0.9 million while outpatient gross revenue increased \$5.6 million.
- The Hospital's operating expenses of \$48.6 million increased by \$2.2 million or 4.7% from the prior year.

Summarized Financial Statement Information

The following financial reports *Net Assets* and *Changes in Net Assets* document in summary form the financial information related to the activities of the Hospital for Calendar Year 2011 and Prior Year 2010. Related notes follow the financial reports.

NET ASSETS		
	2011	2010
Current Assets	\$13.5	\$13.8
Noncurrent Assets	4.5	6.3
Capital Assets	33.6	35.2
Total Assets	51.6	55.3
Current Liabilities	4.5	6.2
Long-Term Debt	16.5	15.5
Total Liabilities	21.0	21.7
Net Assets		
Invested in Capital Assets	17.0	18.2
Restricted	2.4	3.6
Unrestricted	11.2	11.9
Total Net Assets	\$30.6	\$33.6

Current Assets of \$13.5 million decreased \$0.3 million or 2.2% from the prior year. Net receivables decreased \$1.4 million and cash increased by \$1.5 million. Noncurrent assets declined by \$1.8 million.

Long-Term Debt of \$16.5 million increased \$1.0 million or 6.5% from the prior year.

CHANGES IN NET ASSETS		
	2011	2010
Revenue		
Net Patient Service Revenue	\$44.7	\$43.7
Other Revenues	0.8	0.8
Total Revenues	45.5	44.5
Expenses		
Salaries and Benefits	24.7	24.1
Medical Supplies and Drugs	4.3	3.8
Insurance	0.5	0.5
Other Supplies	0.6	0.7
Depreciation and Amortization	3.1	3.5
Other Expenses	15.4	13.8
Total Expenses	48.6	46.4
Operating Loss	-3.1	-1.9
Non-operating Revenues	0.1	0.2
Increase (Decrease) In Net Assets	-3.0	-1.8
Net Assets Beginning of the Year	33.6	35.4
Net Assets End of the Year	\$30.6	\$33.6

Net assets declined \$3.0 million from the prior year. Net assets are the difference between net patient service revenues and the expenses incurred to perform those services.

The primary components for net assets in 2011 are:

- The Hospital's net operating revenues of \$45.5 million increased by \$1.0 million or 2.2% from prior year. Gross inpatient service revenue increased \$0.9 million and outpatient revenue increased \$5.6 million.
- The Hospital's operating expenses of \$48.6 million increased by \$2.2 million or 4.7% from prior year. Interest increased \$0.7 million, supplies increased \$0.4 million, physician fees increased \$0.5 million, salaries and benefits increased \$0.4 million, and depreciation decreased by \$0.3 million.

Capital Assets and Debt Administration

Capital Assets

At the end of 2011, the Hospital had \$33.6 million invested in capital assets. The Hospital had a net decrease of \$1.6 million over prior year. The table displayed below documents the type of assets that makeup the capital assets held by the hospital as of December 31, 2011.

Capital Assets at Year-End Net of Depreciation		
	2011	2010
Land	\$1.3	\$1.3
Land Improvements/Leasehold Improvements	0.7	0.7
Building	38.4	38.4
Equipment	27.9	26.8
Total	68.3	67.2
Less Accumulated Depreciation	34.8	32.2
Subtotal	33.5	35.0
Construction In Progress	0.1	0.2
Capital Assets (Net)	\$33.6	\$35.2

Debt

At year-end, the Hospital had approximately \$20.1 million in long-term debt (financial statements are shown net of bond discount and premium). The table below documents the debt held.

Outstanding Debt at Year End		
	2011	2010
Variable Rate Hospital Revenue Bonds		
2001 Revenue Bonds	\$0.0	\$0.7
2006 Revenue Bonds (Refunded 1998 and 1999 series)	0.0	17.3
2011 (Refunded 2006 series)	20.1	0.0
PACS Capital Lease	0.0	0.2
Total Debt	\$20.1	\$18.2

Contacting the Hospital's Management

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

DAVIESS COMMUNITY HOSPITAL
STATEMENT OF NET ASSETS
December 31, 2011

Assets

Current assets:	
Cash and cash equivalents	\$ 3,142,703
Patient accounts receivable, net of estimated uncollectibles of \$5,071,715	6,173,124
Supplies and other current assets	3,782,471
Noncurrent cash and investments:	
Internally designated	2,147,935
Held by trustee for debt service	2,353,072
Capital assets:	
Land and construction in progress	1,412,516
Depreciable capital assets, net of accumulated depreciation	32,177,461
Other assets	<u>460,556</u>
Total assets	<u>\$ 51,649,838</u>

Liabilities and Net Assets

Current liabilities:	
Accounts payable and accrued expenses	\$ 2,632,721
Other current liabilities	1,901,472
Long-term debt, net of current maturities	<u>16,544,680</u>
Total liabilities	<u>21,078,873</u>
Net assets:	
Invested in capital assets, net of related debt	17,045,297
Restricted:	
For debt service	2,353,072
Unrestricted	<u>11,172,596</u>
Total net assets	<u>30,570,965</u>
Total liabilities and net assets	<u>\$ 51,649,838</u>

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

DAVIESS COMMUNITY HOSPITAL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year Ended December 31, 2011

Operating revenues:	
Net patient service revenue (net of provision for bad debt)	\$ 44,638,328
Other	<u>818,063</u>
Total operating revenues	<u>45,456,391</u>
Operating expenses:	
Salaries and benefits	24,735,265
Medical supplies and drugs	4,252,082
Insurance	466,353
Other supplies	632,398
Other expenses	15,388,418
Depreciation and amortization	<u>3,147,561</u>
Total operating expenses	<u>48,622,077</u>
Operating loss	<u>(3,165,686)</u>
Nonoperating revenues:	
Investment income	36,537
Loss on sale of equipment	(2,660)
Other non-operating expense	(88,096)
Other non-operating revenue	<u>156,038</u>
Total nonoperating revenues	<u>101,819</u>
Decrease in net assets	(3,063,867)
Net assets beginning of the year	<u>33,634,832</u>
Net assets end of the year	<u>\$ 30,570,965</u>

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

DAVIESS COMMUNITY HOSPITAL
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS
Year Ended December 31, 2011

Cash flows from operating activities:	
Receipts from and on behalf of patients	\$ 45,862,635
Payments to suppliers and contractors	(6,011,837)
Payments to employees	(24,735,265)
Other expenses	<u>(14,163,614)</u>
Net cash provided by operating activities	<u>951,919</u>
Cash flows from capital and related financing activities:	
Proceeds from bond issuance	17,562,551
Principal paid on long-term debt	(18,215,432)
Interest paid on long-term debt	(1,394,174)
Purchase of capital assets	(1,310,474)
Proceeds from sale of capital assets	<u>2,621</u>
Net cash used by capital and related financing activities	<u>(3,354,908)</u>
Cash flows from investing activities:	
Proceeds from Investments	1,451,626
Interest and dividends on investments	<u>36,537</u>
Net cash provided by investing activities	<u>1,488,163</u>
Net increase in cash and cash equivalents	(914,826)
Cash and cash equivalents at beginning of year	<u>6,410,600</u>
Cash and cash equivalents at end of year	<u><u>\$ 5,495,774</u></u>
Cash and cash equivalents in current assets	\$ 3,142,703
Restricted cash and cash equivalents	<u>2,353,071</u>
Total cash and cash equivalents	<u><u>\$ 5,495,774</u></u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (3,165,686)
Adjustments to reconcile operating loss to net cash flows used in operating activities:	
Depreciation and amortization	3,147,561
Provision for bad debt	2,647,771
Other nonoperating revenues	67,942
Loss on sale of equipment	(2,660)
(Increase) decrease in current assets:	
Patient accounts receivable	(1,423,464)
Supplies and other current assets	71,722
Other assets	(357,134)
Increase in current liabilities:	
Accounts payable and accrued expenses	(732,726)
Other current liabilities	<u>698,593</u>
Net cash provided in operating activities	<u><u>\$ 951,919</u></u>

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

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

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

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

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

Blended Component Units

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

B. Enterprise Fund Accounting

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

C. Assets, Liabilities, and Net Assets or Equity

1. Deposits and Investments

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

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

Other investments are generally reported at fair value.

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

2. Use of Estimates

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

3. Capital Assets

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

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

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

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

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

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Net Assets

Net assets of the Hospital are classified in three components.

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

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

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

The financial statements report \$30,570,965 of restricted net assets, of which no amount is restricted by enabling legislation.

D. Grants and Contributions

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

E. Restricted Resources

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

F. Operating Revenues and Expenses

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

G. Compensated Absences

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

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

H. Net Patient Service Revenue

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

I. Premium Revenue

The Hospital had agreements with various health management organizations (HMO's) to provide medical services to subscribing participants. Under these agreements, the Hospital receives monthly capitation payments based on the number of each HMO's participants, regardless of services actually performed by the Hospital. In addition, the HMO's make fee-for-service payments to the Hospital for certain covered services based upon discounted fee schedules.

J. Charity Care

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

K. Supplies

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

II. Detailed Notes

A. Deposits

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

B. Accounts Receivable and Payable

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

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

<u>Patient Accounts Receivable</u>	
Receivable from patients and their insurance carriers	\$ 6,230,425
Receivable from Medicare	3,687,725
Receivable from Medicaid	<u>1,326,689</u>
Total patient accounts receivable	11,244,839
Less allowance for uncollectible amounts	<u>5,071,715</u>
Patient accounts receivable, net	<u>\$ 6,173,124</u>
<u>Accounts Payable and Accrued Expenses</u>	
Payable to employees (including payroll taxes)	\$ 980,071
Payable to suppliers	<u>1,652,649</u>
Total accounts payable and accrued expenses	<u>\$ 2,632,720</u>

C. Capital Assets

Capital asset activity for the year ended December 31, 2011, was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 1,280,955	\$ -	\$ -	\$ 1,280,955
Construction in progress	<u>251,492</u>	<u>248,849</u>	<u>368,780</u>	<u>131,561</u>
Total capital assets, not being depreciated	<u>1,532,447</u>	<u>248,849</u>	<u>368,780</u>	<u>1,412,516</u>
Capital assets, being depreciated:				
Land improvements	726,983	-	-	726,983
Buildings and improvements	38,380,994	28,478	-	38,409,472
Equipment	<u>26,776,189</u>	<u>1,401,927</u>	<u>318,473</u>	<u>27,859,643</u>
Totals	<u>65,884,166</u>	<u>1,430,405</u>	<u>318,473</u>	<u>66,996,098</u>
Less accumulated depreciation for:				
Land improvements	412,739	18,346	-	431,085
Buildings and improvements	13,460,242	1,045,832	-	14,506,074
Equipment	<u>18,310,311</u>	<u>1,884,360</u>	<u>313,192</u>	<u>19,881,480</u>
Totals	<u>32,183,292</u>	<u>2,948,538</u>	<u>313,192</u>	<u>34,818,638</u>
Total capital assets, being depreciated, net	<u>33,700,874</u>	<u>(1,518,133)</u>	<u>5,281</u>	<u>32,177,460</u>
Total primary government capital assets, net	<u>\$ 35,233,321</u>	<u>\$ (1,269,284)</u>	<u>\$ 374,061</u>	<u>\$ 33,589,976</u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

D. Construction Commitments

Construction work in progress is composed of the following:

<u>Project</u>	<u>Total Project Authorized</u>	<u>Expended to December 31, 2011</u>	<u>Committed</u>	<u>Required Future Funding</u>
IT Project	\$ 1,765	\$ 1,765	\$ -	\$ -
EMR Practice Management	<u>161,645</u>	<u>129,796</u>	<u>-</u>	<u>31,849</u>
Totals	<u>\$ 163,410</u>	<u>\$ 131,561</u>	<u>\$ -</u>	<u>\$ 31,849</u>

E. Leases

1. Operating Leases

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

2012	\$ 61,213
2013	61,214
2014	56,962
2015	10,200
2016-2020	36,550
2021-2025	<u>-</u>
Total minimum rental payments	<u>\$ 226,139</u>

F. Long-Term Liabilities

1. Revenue Bonds

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

<u>Purpose</u>	<u>Interest Rates</u>	<u>Amount</u>
2011 Refunding revenue bonds for hospital improvements	Variable	<u>\$ 20,135,000</u>
Total		<u>\$ 20,135,000</u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Revenue bonds debt service requirements to maturity are as follows:

Year Ended December 31	Principal	Interest
2012	\$ -	\$ 974,625
2013	820,000	962,325
2014	840,000	937,425
2015	870,000	903,075
2016	910,000	858,575
2017-2021	5,220,000	3,640,681
2022-2026	6,615,000	2,179,406
2027-2031	4,860,000	391,650
2032-2036	-	-
Totals	<u>\$ 20,135,000</u>	<u>\$ 10,847,762</u>

2. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2011, was as follows:

Primary Government	Beginning Balance	Additions	Reductions	Ending Balance	Short-Term Portion Due within one year
Bonds payable:					
Revenue:					
Hospital association	\$ 755,280	\$ -	\$ 755,280	\$ -	\$ -
Other revenue bonds	17,270,000	-	17,270,000	-	-
Refunding revenue bond					
Series 2011	-	20,135,000	-	20,135,000	-
Bond premium	-	82,924	3,115	79,809	-
Less deferred loss on refunding	<u>1,149,641</u>	<u>2,655,373</u>	<u>134,885</u>	<u>3,670,129</u>	<u>-</u>
Total bonds payable	16,875,639	17,562,551	17,893,510	16,544,680	-
Capital leases	<u>190,152</u>	<u>-</u>	<u>190,152</u>	<u>-</u>	<u>-</u>
Total long-term liabilities	<u>\$ 17,065,791</u>	<u>\$ 17,562,551</u>	<u>\$ 18,083,662</u>	<u>\$ 16,544,680</u>	<u>\$ -</u>

G. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were \$1,547,137 for 2011.

H. Internally Designated Assets

Noncurrent cash and investments internally designated include the following:

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

Internally designated:	
Funded depreciation:	
Investments	\$ 1,596,838
Board designation:	
Investment	<u>551,097</u>
Total internally designated	<u><u>\$ 2,147,935</u></u>

I. Net Patient Services Revenue

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

1. Medicare

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

2. Medicaid

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

Revenue from the Medicare and Medicaid programs accounted for approximately 44.4 percent and 6.4 percent, respectively, of the Hospital's net patient revenue for the year ended 2011, and 42.9 percent and 6.0 percent, respectively, of the Hospital's net patient revenue for the year ended 2010. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The 2011 net patient service revenue increased approximately \$142,124 as a result of interim settlements for prior years.

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

III. Other Information

A. Risk Management

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

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

Medical Benefits to Employees

The Hospital has chosen to establish a risk financing fund for risks associated with medical benefits to employees. The risk financing fund is accounted for in the operating fund where assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of \$80,000 per year. Settled claims resulting from this risk did not exceed commercial insurance coverage in the past year.

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

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

	<u>2011</u>	<u>2010</u>
Unpaid claims, beginning of fiscal year	\$ 216,800	\$ 204,131
Incurred claims and changes in estimates	2,661,592	2,397,465
Claim payments	<u>(2,649,413)</u>	<u>(2,384,796)</u>
Unpaid claims, end of fiscal year	<u>\$ 228,979</u>	<u>\$ 216,800</u>

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

B. Contingent Liabilities

Litigation

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

C. Fair Value of Financial Instruments

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

Cash and Cash Equivalents

The carrying amount reported in the Statement of Net Assets for cash and cash equivalents approximates its fair value.

Short-Term Investments

The carrying amount reported in the Statement of Net Assets is the investment's fair value on the day it becomes a short-term investment.

Investments

Fair values, which are the amounts reported in the Statement of Net Assets, are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Accounts Payable and Accrued Expenses

The carrying amount reported in the Statement of Net Assets for accounts payable and accrued expenses approximates its fair value.

D. Fair Value Measurements

Statement on Financial Accounting Standards 157, Fair Value Measurements (as amended), requires certain disclosures regarding the fair value of financial instruments. Financial instruments held by the Hospital impacted by this pronouncement include the Hospital's investments and assets whose use is limited which are measured using quoted prices in active markets and other significant observable inputs.

The Hospital partially adopted the provisions of FAS 157 for fiscal year 2008, but will delay adoption of non-financial assets and non-financial liabilities covered by FASB Staff Position FAS 157-2. This Staff Position permits entities to partially defer the effective date of FAS 157 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, until fiscal year 2009.

When fully adopted, the Hospital will apply the provisions of FAS 157-2 to certain non-financial assets and liabilities and is currently evaluating the impact of the full adoption of this statement on the activities, changes in net assets and financial position. Using the provisions within SFAS 157, the Hospital has characterized its investments in securities, based on the priority of the inputs used to value the investments, into a three-level fair value hierarchy. The fair value hierarchy gives the

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

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

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

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

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

Based upon the levels as defined the Hospital's investments as of December 31, 2011, are classified as follows:

Investment Type	12-31-11	Fair Value Measurements at Reporting Date Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government Securities	\$ -	\$ -	\$ -	\$ -
Certificates of deposit	2,147,935	-	2,147,935	-
Mutual funds	-	-	-	-
Totals	<u>\$ 2,147,935</u>	<u>\$ 143,051</u>	<u>\$ 2,147,935</u>	<u>\$ -</u>

E. Pension Plans

Plan Description

The Hospital has two defined contribution pension plans administered by Principal Financial Group as authorized by Indiana Code 8-1.5-3-7. The plans provide retirement, disability, and death benefits to plan members and beneficiaries. The plans were established and can be amended by written agreement between the governing board of the unit and the plan administrator. The plan administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plans. That report may be obtained by contacting:

DAVIESS COMMUNITY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Principal Mutual Life Insurance Company
711 High Street
Des Moines, IA 50392-0001
Ph. (515) 247-5111
www.principal.com

Funding Policy and Annual Pension Cost - (401a) Money Purchase Plan

The contribution requirements of plan members are established and can be amended by the written agreement between the governing board of the unit and the plan administrator. Eligible employees are those employees 21 years of age or older working at Daviess Community Hospital for (1) year with a minimum of 1000 hours of service during the plan year. After one year of service the Hospital will contribute 1.5 percent of the eligible employee's gross wage to the plan. The employee becomes vested in the 401a plan contributions based on the following schedule. Employer scheduled contributions for 2011 plan participants are \$200,000.

Less than 3 years	0%
Three years	50%
Four years	75%
Five years	100%

Funding Policy and Annual Pension Cost - 403(b) Tax Deferred Annuity Plan

The contribution requirements of plan members are established and can be amended by the written agreement between the governing board of the unit and the plan administrator. Eligible employees are those employees 21 years of age or older who work a minimum of 1000 hours in the year. Employees may contribute on the date of hire to the 403(b) plan. After one year of service the Hospital will match 50 percent of the employee's contribution up to a maximum of 4 percent contribution. Participants over 50 years of age may make catch-up contributions. Catch-up contributions are 403(b) elective deferral contributions in excess of any limits on such contributions under the plan. The above vesting schedule is likewise used for employer contributions under the 403(b) plan. Employee's own contributions are 100 percent vested, as well as, any earnings on their contributions. Employer and employee contributions to the 2011 plan were \$171,664 and \$586,034, respectively.

DAVIESS COMMUNITY HOSPITAL
AUDIT RESULT AND COMMENT

CONDITION OF RECORDS

The Capital Asset subsidiary ledger is not in agreement with the amount reflected on the general ledger.

At all times, the manual and computerized records, subsidiary ledgers, control ledger, and reconciled bank balance should agree. If the reconciled bank balance is less than the subsidiary or control ledgers, then the responsible official or employee may be held personally responsible for the amount needed to balance the fund. (Accounting and Uniform Compliance Guidelines Manual for County and City Hospitals, Chapter 1)

DAVIESS COMMUNITY HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on August 7, 2012, with Catherine E. Keck, Interim Chief Financial Officer; Kenneth Parsons, Chairman of the Board of Governors; and Anthony R. Showalter, Board of Governors.