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June 8, 2017

Board of Trustees
Sullivan County Community Hospital
2200 North Section Street, PO Box 10
Sullivan, IN 47882

We have reviewed the audit report prepared by BKD, LLP, Independent Public Accountants, for the period January 1, 2016 to December 31, 2016. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Auditor's Report, the financial statements included in the report present fairly the financial condition of the Sullivan County Community Hospital, as of December 31, 2016 and the results of its operations for the period then ended, on the basis of accounting described in the report.

The audit report is filed with this letter in our office as a matter of public record.

The Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards* reports one material weakness and one significant deficiency. These findings are included in the Schedule of Findings and Responses.

A handwritten signature in blue ink that reads "Paul D. Joyce".

Paul D. Joyce, CPA
State Examiner

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana

Independent Auditor's Report and Financial Statements
December 31, 2016 and 2015

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
December 31, 2016 and 2015

Table of Contents

Independent Auditor's Report.....	1
Management's Discussion and Analysis	3
Financial Statements	
Balance Sheets.....	8
SCCH Fitness Center, Inc. - Statements of Financial Position.....	9
Statements of Revenues, Expenses and Changes in Net Position	10
SCCH Fitness Center, Inc. - Statements of Activities.....	11
Statements of Cash Flows	12
Notes to Financial Statements	13
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	28
Schedule of Findings and Responses	30

Independent Auditor's Report

Board of Trustees
Sullivan County Community Hospital
Sullivan, Indiana

Report on the Financial Statements

We have audited the accompanying financial statements of Sullivan County Community Hospital (Hospital), a component unit of Sullivan County, Indiana, and SCCH Fitness Center, Inc., the Hospital's discretely presented component unit as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Sullivan County Community Hospital and its discretely presented component unit as of December 31, 2016 and 2015, and the respective changes in financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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 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 audits 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 23, 2017 on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

BKD, LLP

Indianapolis, Indiana
May 23, 2017

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

Management's Discussion and Analysis

Years Ended December 31, 2016 and 2015

Introduction

This management's discussion and analysis of the financial performance of Sullivan County Community Hospital (Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2016 and 2015. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and investments decreased in 2016 by \$1,939,077 or 11.5% compared to an increase of \$1,368,319 or 8.8% in 2015.
- The Hospital's net position decreased in 2016 by \$277,130 or 0.9% compared to an increase of \$266,434 or .8% in 2015.
- The Hospital reported operating loss in 2016 of \$238,107 after reporting operating income in 2015 of \$331,826. Operating results in 2016 decreased by \$569,933 of 171.8% while in 2015, the operating results decreased by \$925,016 or 73.6%.
- Net nonoperating expenses for 2016 were \$39,023 compared to net nonoperating expenses of \$65,392 for 2015. This is an increase of net nonoperating activity of \$26,369 or 40.3%. In 2015, net nonoperating activity decreased by \$125,542 or 208.7%.

Using This Annual Report

The Hospital's financial statements consist of three statements—the balance sheets; the statements of revenues, expenses and changes in net position; and the statements of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheets and Statements of Revenues, Expenses and Changes in Net Position

One of the most important questions asked about any hospital's finances is "Is the hospital as a whole better or worse off as a result of the year's activities?" The balance sheets and the statements of revenues, expenses and changes in net position report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net position and changes in them. The Hospital's total net position—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net position are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients, and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statements of Cash Flows

The statements of cash flows report cash receipts, cash payments, and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash and cash equivalents during the reporting period.

The Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the balance sheets. The Hospital's net position decreased by \$277,130 or 0.9% in 2016 over 2015 compared to an increase in net position of \$266,434 or 0.8% in 2015 over 2014 as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2016	2015	2014
Assets			
Patient accounts receivable, net	\$ 3,476,184	\$ 3,344,057	\$ 3,960,234
Other current assets	6,438,174	6,920,036	2,737,590
Capital assets, net	14,388,027	13,585,472	13,925,257
Other noncurrent assets	11,091,706	11,037,515	14,012,907
Total assets	<u>\$ 35,394,091</u>	<u>\$ 34,887,080</u>	<u>\$ 34,635,988</u>
Liabilities	<u>\$ 3,543,634</u>	<u>\$ 2,759,493</u>	<u>\$ 2,774,835</u>
Net Position			
Net investment in capital assets	14,388,027	13,585,472	13,925,257
Unrestricted	17,462,430	18,542,115	17,935,896
Total net position	<u>31,850,457</u>	<u>32,127,587</u>	<u>31,861,153</u>
Total liabilities and net position	<u>\$ 35,394,091</u>	<u>\$ 34,887,080</u>	<u>\$ 34,635,988</u>

A significant change in the Hospital's assets in 2016 is the decrease in other current assets of \$481,862 or 7.0%. This decrease was a result of a decrease in cash of \$1,993,268 due to a decline in cash provided by operating activities and increases in purchases of capital assets. This decrease was offset by an increase in estimated amounts due from third-party payers based on the timing of payments from the state. Patient accounts receivable increased by \$132,127 or 4.0% in 2016 as a result of stable collection efforts and an increase in net patient service revenue of \$1,352,098 or 4.4%.

A significant change in the Hospital's assets in 2015 was a decrease in patient accounts receivable of \$616,177 or 15.6%. This decrease was a result of slight increases in net patient service revenue of \$535,400 or 1.8% in 2015 with improved collections during the same period. This decrease in patient receivables represents approximately 8 days of revenue.

Another significant change in the Hospital's financial position in 2015 was an increase in cash and investments of approximately \$1,368,000 or 8.8%. This increase was largely driven by the decrease in net patient accounts receivable with improved collections during 2015 on clinic receivable balances.

Operating Results and Changes in the Hospital's Net Position

In 2016, the Hospital's net position decreased by \$277,130 or 0.9%, as shown in Table 2. This decrease is made up of several different components and represents a decrease of 171.8% compared with the increase in net position for 2015 of \$266,434. In 2015, the increase in net position of \$266,434 represents a decrease of 79.7% compared with the increase in net position for 2014 of \$1,316,992.

Table 2: Operating Results and Changes in Net Position

	2016	2015	2014
Operating Revenues			
Net patient service revenue	\$ 31,932,466	\$ 30,408,368	\$ 29,872,951
Other operating revenues	157,329	200,487	379,175
Total operating revenues	<u>32,089,795</u>	<u>30,608,855</u>	<u>30,252,126</u>
Operating Expenses			
Salaries and wages and employee benefits	19,964,059	18,364,944	16,464,400
Purchased services and professional fees	4,107,114	4,050,431	3,512,337
Depreciation and amortization	1,682,220	1,641,981	1,756,510
Other operating expenses	6,574,509	6,219,673	7,262,037
Total operating expenses	<u>32,327,902</u>	<u>30,277,029</u>	<u>28,995,284</u>
Operating Income (Loss)	<u>(238,107)</u>	<u>331,826</u>	<u>1,256,842</u>
Nonoperating Revenues (Expenses)			
Investment income	57,148	48,551	46,297
Other	(96,171)	(113,943)	13,853
Total nonoperating revenues (expenses)	<u>(39,023)</u>	<u>(65,392)</u>	<u>60,150</u>
Increase (Decrease) in Net Position	<u>\$ (277,130)</u>	<u>\$ 266,434</u>	<u>\$ 1,316,992</u>

Operating Income

The first component of the overall change in the Hospital's net position is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. The Hospital has reported operating income in two of the last three years, with an operating loss in 2016.

The operating loss was \$238,107 for 2016 compared to operating income of \$331,826 for 2015, which equates to a decrease of \$569,933, or 171.8%, while the operating income for 2015 decreased by \$925,016 or 73.6% as compared to 2014. The primary components of the decreased operating income in 2016 are:

- Net patient service revenue was \$31,932,466 for 2016 compared to \$30,408,368 in 2015, which is an increase of \$1,524,098 or 5.0%.
- Salaries, wages and benefits for the Hospital's employees were \$19,964,059 for 2016 compared to \$18,364,944 for 2015, which results in an increase of \$1,599,115 or 8.7%.
- Purchased services and professional fees for the Hospital were \$4,107,114 for 2016 compared to \$4,050,431 for 2015, which results in an increase of \$56,683 or 1.4%.

One component of the increase in net patient service revenue was an overall increase in Hospital inpatient volumes and clinic related visits. Volume increases were partially offset by lower Hospital outpatient volumes.

Employee salaries and wages and benefits increased in both 2016 and 2015 in connection with the Hospital's retention and recruitment efforts. These efforts result primarily from the shortage of nurses and other health care professionals in the United States. Additionally, the Hospital saw an increase in health insurance related costs from its self-employed plan.

The rate of health care inflation has a direct effect on the cost of services provided by the Hospital. Expenditures for supplies and prescription drugs are a major component of the Hospital's costs. In 2016, supplies and prescription drug costs totaled \$2,890,851, or 8.9%, of total operating expenses. In 2015, they totaled \$2,790,750 or 9.2%, of total operating expenses.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income, rental income on Hospital-owned property and payments made to subsidize the Hospital's discretely presented component unit. Changes in investment and rental income were insignificant in 2016 and 2015. The Hospital's subsidy of its discretely presented component unit decreased by approximately \$22,000 or 9.5% to \$209,833 in 2016. The Hospital recognized a loss of \$63,874 from its equity method investment in 2016.

The Hospital's Cash Flows

The Hospital's operating cash flows decreased \$2,433,564 in 2016 compared to 2015. The primary driver of this decrease was a decrease in cash receipts from patients and an increase in payments to suppliers and employees. The Hospital's cash flows from capital and related financing activity increased by \$849,201 in 2016 compared to 2015 as a result of overall Hospital improvement and facility changes. The Hospital's cash flows from investing activities decreased by \$3,054,214 in 2016 compared to 2015 as a result of the limited investment activity in 2016 compared to the disposition of certain investments that were transferred to cash for use in operations in 2015.

Capital Asset and Debt Administration

Capital Assets

At the end of 2016, the Hospital had \$14,388,027 invested in capital assets, net of accumulated depreciation. In 2016 and 2015, the Hospital had capital acquisitions of approximately \$2,480,000 and \$1,300,000, respectively. The majority of these purchases were related to replacement equipment, business office remodel, and overall facility changes. Please reference Note 5 of the audited financial statements for additional disclosures concerning capital asset activity.

Debt

The Hospital issued no new debt in 2016 or 2015, and has no outstanding debt as of December 31, 2016 or 2015.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital Administration by telephoning (812) 268-4311.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Balance Sheets
December 31, 2016 and 2015

Assets

	<u>2016</u>	<u>2015</u>
Current Assets		
Cash	\$ 3,856,336	\$ 5,849,604
Patient accounts receivable, net of allowance: 2016 - \$1,568,240, 2015 - \$2,179,669	3,476,184	3,344,057
Supplies	672,824	619,615
Estimated amounts due from third-party payers	1,263,519	-
Prepaid expenses and other current assets	645,495	450,817
Total current assets	<u>9,914,358</u>	<u>10,264,093</u>
Noncurrent Investments - Funded depreciation	11,091,706	11,037,515
Capital Assets	<u>14,388,027</u>	<u>13,585,472</u>
Total assets	<u><u>\$ 35,394,091</u></u>	<u><u>\$ 34,887,080</u></u>

Liabilities and Net Position

Current Liabilities		
Accounts payable	\$ 1,209,093	\$ 895,422
Accrued expenses	2,154,138	1,744,231
Estimated amounts due to third-party payers	180,403	119,840
Total current liabilities	<u>3,543,634</u>	<u>2,759,493</u>
Net Position		
Net investment in capital assets	14,388,027	13,585,472
Unrestricted	17,462,430	18,542,115
Total net position	<u>31,850,457</u>	<u>32,127,587</u>
Total liabilities and net position	<u><u>\$ 35,394,091</u></u>	<u><u>\$ 34,887,080</u></u>

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

SCCH Fitness Center, Inc.

Statements of Financial Position

December 31, 2016 and 2015

Assets

	2016	2015
Property and equipment, net of accumulated depreciation of \$848,448 and \$785,490 for 2016 and 2015, respectively	\$ 434,211	\$ 493,328
Total assets	\$ 434,211	\$ 493,328

Liabilities and Net Assets

Liabilities

Accrued expenses	\$ 39,834	\$ 28,261
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Net Assets - Unrestricted

	394,377	465,067
Total liabilities and net assets	\$ 434,211	\$ 493,328

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts of \$2,039,874 and \$3,576,647 for 2016 and 2015, respectively	\$ 31,932,466	\$ 30,408,368
Other	157,329	200,487
Total operating revenues	<u>32,089,795</u>	<u>30,608,855</u>
Operating Expenses		
Salaries and wages	15,441,301	14,601,737
Employee benefits	4,522,758	3,763,207
Purchased services and professional fees	4,107,114	4,050,431
Supplies	2,890,851	2,790,750
Utilities	443,852	415,895
Repair and maintenance	1,393,393	1,154,428
Leases and rentals	323,247	324,248
Insurance	419,900	426,404
Depreciation and amortization	1,682,220	1,641,981
Other	643,293	586,485
Provider hospital assessment fee	459,973	521,463
Total operating expenses	<u>32,327,902</u>	<u>30,277,029</u>
Operating Income (Loss)	<u>(238,107)</u>	<u>331,826</u>
Nonoperating Revenues (Expenses)		
Investment income	57,148	48,551
Other	(96,171)	(113,943)
Total nonoperating expenses	<u>(39,023)</u>	<u>(65,392)</u>
Increase (Decrease) in Net Position	(277,130)	266,434
Net Position, Beginning of Year	<u>32,127,587</u>	<u>31,861,153</u>
Net Position, End of Year	<u><u>\$ 31,850,457</u></u>	<u><u>\$ 32,127,587</u></u>

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

SCCH Fitness Center, Inc.

Statements of Activities

Years Ended December 31, 2016 and 2015

	2016	2015
Revenues, Gains and Other Support		
Membership, training, class and other revenue	\$ 224,479	\$ 431,942
Operating support from the Hospital	209,884	-
Total revenues, gains and other support	<u>434,363</u>	<u>431,942</u>
Expenses		
Salaries and wages	261,721	218,723
Employee benefits	100,294	100,535
Purchased services	33,200	28,212
Supplies	5,339	5,676
Utilities	19,233	18,379
Repair and maintenance	5,474	9,519
Depreciation	62,958	59,076
Other	16,834	25,412
Total expenses	<u>505,053</u>	<u>465,532</u>
Decrease in Net Assets	(70,690)	(33,590)
Unrestricted Net Assets, Beginning of Year	<u>465,067</u>	<u>498,657</u>
Unrestricted Net Assets, End of Year	<u>\$ 394,377</u>	<u>\$ 465,067</u>

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Statements of Cash Flows
Years Ended December 31, 2016 and 2015

	2016	2015
Operating Activities		
Receipts from and on behalf of patients	\$ 30,137,410	\$ 31,330,315
Payments to suppliers and contractors	(9,784,664)	(9,058,624)
Payments to employees	(19,679,313)	(18,628,323)
Other payments, net	(371,090)	(907,461)
Net cash provided by operating activities	<u>302,343</u>	<u>2,735,907</u>
Capital and Related Financing Activity - purchase of capital assets	<u>(2,151,397)</u>	<u>(1,302,196)</u>
Investing Activities		
Interest and dividends on investments	57,148	40,591
Purchase of investments	(8,046,001)	(8,082,788)
Proceeds from disposition of investments	7,991,810	11,066,140
Other investing activities	(147,171)	(113,943)
Net cash provided by (used in) investing activities	<u>(144,214)</u>	<u>2,910,000</u>
Increase (Decrease) in Cash	(1,993,268)	4,343,711
Cash, Beginning of Year	<u>5,849,604</u>	<u>1,505,893</u>
Cash, End of Year	<u><u>\$ 3,856,336</u></u>	<u><u>\$ 5,849,604</u></u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities		
Operating income (loss)	\$ (238,107)	\$ 331,826
Depreciation	1,682,220	1,641,981
Provision for uncollectible accounts	2,039,874	3,576,647
Changes in operating assets and liabilities:		
Patient accounts receivable	(2,172,001)	(2,960,470)
Estimated amounts due to/from third-party payers	(1,202,956)	305,770
Accounts payable and accrued expenses	390,200	(135,182)
Other assets	(196,887)	(24,665)
Net cash provided by operating activities	<u><u>\$ 302,343</u></u>	<u><u>\$ 2,735,907</u></u>
Supplemental Cash Flow Information		
Purchase of capital assets included in accounts payable	\$ 333,378	\$ -

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

Notes to Financial Statements

December 31, 2016 and 2015

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

Sullivan County Community Hospital (Hospital) is an acute care hospital located in Sullivan, Indiana. The Hospital is a component unit of Sullivan County (County) and the Board of County Commissioners appoints members to the Governing Board of the Hospital pursuant to the provisions of Indiana Code 16-22-2-2. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Sullivan County surrounding area. It also operates a home health agency in the same geographic area.

In accordance with GASB Statement No. 61, the financial statements include the financial statements of MSO Clinics, Inc. (MSO Clinics), reported as a blended component unit. The primary government appoints a voting majority of the MSO Clinics' board of directors and a financial benefit/burden relationship exists between the Hospital and MSO Clinics. Although it is legally separate from the Hospital, MSO Clinics is reported as if it were a part of the Hospital as it provides services entirely or almost entirely for the benefit of the Hospital. All significant intercompany transactions have been eliminated for financial reporting purposes. Separate audited financial statements are not issued for MSO Clinics.

During 2016, the Hospital invested for a 51% ownership in Sullivan County Community Hospital Pain Management, LLC (Pain Management), which was organized to offer pain management services in the Hospital's primary service area. The Hospital's ownership interest is accounted for under the equity method. Separate audited financial statements are not issued for Pain Management.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Investment income is included in nonoperating revenues and expenses.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Risk Management

The Hospital 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; medical malpractice; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than employee health claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Hospital is self-insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured portion of employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and Investment Income

Investments in nonnegotiable certificates of deposit are carried at amortized cost. The investment in equity investee is reported on the equity method of accounting. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income includes dividend and interest income and the net change for the year in the fair value of investments carried at fair value.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. The following estimated useful lives are being used by the Hospital:

Land improvements	5 - 20 years
Buildings and leasehold improvements	10 - 20 years
Equipment	3 - 10 years

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

Notes to Financial Statements

December 31, 2016 and 2015

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense and the related liability for sick leave benefits are recognized to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date, plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date. The estimated compensated absences liability are expected to be paid within one year of the balance sheet date and is therefore included in current liabilities.

Net Position

Net position of the Hospital is classified in two components. Net investment in capital assets, consist of capital assets, net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Unrestricted net position are remaining assets, less remaining liabilities that do not meet the definition of net investment in capital assets.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were \$930,654 for 2016 compared to \$671,512 for 2015.

SCCH Fitness Center

SCCH Fitness Center, Inc. (Fitness Center) is a legally separate, tax-exempt component unit of the Hospital. The Fitness Center's primary function is to provide community access to health and fitness equipment. The Hospital appoints a voting majority of the Fitness Center's board and a financial relationship exists where the Hospital subsidizes the operations of the Fitness Center. Because of this relationship, the Fitness Center is considered a component unit of the Hospital and is discretely presented in the Hospital's financial statements. Separate financial statements for the Fitness Center may be obtained by contacting Fitness Center management.

During the years ended December 31, 2016 and 2015, the Hospital provided \$209,884 and \$231,821, respectively, of support to the Fitness Center for operations.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. In addition, the Hospital is exempt from taxes under Section 501(c)(3) of the Internal Revenue Code. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

The Fitness Center is exempt from federal income taxes under Section 501(c)(3) and 509(a)(2) of the U.S. Internal Revenue Code and a similar provision of state law. However, the Fitness Center is subject to federal income tax on any unrelated business taxable income. The Fitness Center files federal tax returns in the U.S. federal jurisdiction.

MSO Clinics is exempt from federal income taxes under Section 501(c)(3) of the U.S. Internal Revenue Code and a similar provision of state law. However, MSO Clinics is subject to federal income tax on any unrelated business taxable income. MSO Clinics files federal tax returns in the U.S. federal jurisdiction.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Critical access hospitals (CAHs) are eligible to receive incentive payments in the cost reporting period beginning in the federal fiscal year in which meaningful use criteria have been met. The Medicare incentive payment is for qualifying costs of the purchase of certified EHR technology multiplied by the Hospital's Medicare share fraction, which includes a 20% incentive. This payment is an acceleration of amounts that would have been received in future periods based on reimbursable costs incurred, including depreciation. If meaningful use criteria are not met in future periods, the Hospital is subject to penalties that would reduce future payments for services. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. The final amount for any payment year under both programs is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Hospital began recognizing incentive payment revenue earned under the Medicare program in 2014, which was the period during which management was reasonably assured meaningful use was achieved and the earnings process was complete. The Hospital recorded revenue of approximately \$460,000 from Medicare in 2014, which is included in net patient service revenue in the statements of revenues, expenses and changes in net position. This estimate was reduced by \$130,000 in 2015 when the application for payment was made and no additional amounts were recorded. During 2016, amounts approximating \$360,000 were received related to the original attestation and no additional funds are expected.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known. A summary of payment arrangements include:

Medicare. The Hospital is designated by Medicare as a critical access hospital (CAH). Inpatient acute care and swing bed services, and most outpatient services, are reimbursed based on a cost reimbursement methodology. Interim per diem rates for inpatient services and percent of charges for outpatient services are reimbursed throughout the year, with final settlement determined after submission of the annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Medicaid. Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates. These rates vary according to the service provided and the patient diagnosis.

Approximately 51% and 53% percent of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2016 and 2015, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital qualifies as a Medicaid Disproportionate Share Hospital (DSH) provider under Indiana law and, as such, is eligible to receive supplemental Medicaid payments. The amounts of these supplemental payments are dependent on regulatory approval by agencies of the federal and state governments and is determined by level, extent and cost of uncompensated care and various other factors. Supplemental payments have been made by the State of Indiana, and the Hospital records such amounts as revenue when it has been reasonably determined that the funds will be received. The Hospital recognized approximately \$955,000 and \$1,337,000 within net patient service revenue related to this supplemental payment program for the years ended December 31, 2016 and 2015, respectively.

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

Notes to Financial Statements

December 31, 2016 and 2015

The Hospital participates in a state specific provider assessment fee program to increase Medicaid payments to hospitals. The Hospital incurred fees approximating \$460,000 and \$521,000 related to this program for 2016 and 2015, respectively, which are recorded as an operating expense in the statements of revenues, expenses and changes in net position. In January 2017, the Hospital received notice that its Medicaid Inpatient Utilization Rate (MIUR) exceeded state-wide thresholds, as defined by state regulation. A benefit of having a MIUR exceeding this threshold includes a 25% reduction in the provider assessment fee for the period July 1, 2015 through June 30, 2017. During 2016, the Hospital reduced its recorded expense by approximately \$244,000, which represents the 25% benefit restorative to July 1, 2015. The provider assessment fee program is subject to further retroactive rate setting by the state of Indiana and its Medicaid program and the amounts expensed represent the current fees that have been assessed to the Hospital, including the 25% benefit. The program is scheduled to sunset on June 30, 2017. There is no assurance this program will continue to be implemented in the future.

The results of the state's MIUR measurement are subject to appeal by all providers. It is possible that another provider's appeal could result in a change in the Hospital's MIUR eligibility as the MIUR threshold is adjusted. Additionally, the state measures MIUR percentages no less than every two years and no more than every four years. At each measurement period, the state-defined MIUR threshold changes which could affect the Hospital's eligibility status. Any change in MIUR eligibility would affect the Hospital's ability to receive the 25% provider assessment fee reduction. Any change in the amount of tax due as a result of eligibility changes will be recorded in the period once the state has made its determination.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Note 3: Deposits, Investments and Investment Income

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of state law.

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depositary Insurance Corporation (FDIC) or by the Indiana Public Deposit Insurance Fund (IPDIF). This includes any deposit accounts issued or offered by a qualifying financial institution. Accordingly, all deposits in excess of FDIC levels are covered by the IPDIF and are considered collateralized.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Investments

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities, in bank repurchase agreements, and other investments defined in Indiana Code 16-22-3-20.

Interest Rate Risk - As a means of limiting its exposure to fair value losses arising from rising interest rates, the Hospital's investment policy limits investments to certificates of deposit and certain bond and mutual funds. No more than 50% of the total Hospital portfolio (including deposits) should be invested in bond mutual funds. Generally, the maturity date on all investments shall not exceed two years.

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in certain bond and mutual funds to the American Hospital Association's Investment Fund and other portfolios with AAA or government-backed ratings.

Custodial Credit Risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The Hospital's investment policy does not address how securities underlying repurchase agreements are to be held.

Concentration of Credit Risk - The Hospital places no limit on the amount that may be invested in any one issuer.

Summary of Carrying Values

The carrying values of deposits shown above are included in the balance sheets as follows:

	2016	2015
Carrying value:		
Deposits	\$ 14,948,042	\$ 16,887,119
Included in the following balance sheets captions:		
Cash	\$ 3,856,336	\$ 5,849,604
Noncurrent investments - funded depreciation	11,091,706	11,037,515
	\$ 14,948,042	\$ 16,887,119

Non-negotiable certificates of deposit totaling \$11,091,706 and \$11,037,515 are included in deposit balances at December 31, 2016 and 2015, respectively.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Investment Income

Investment income for the years ended December 31 consisted of:

	2016	2015
Interest and dividend income	\$ 57,148	\$ 40,591
Net change in fair value of investments	-	7,960
	<u>\$ 57,148</u>	<u>\$ 48,551</u>

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31 consisted of:

	2016	2015
Medicare	\$ 879,503	\$ 863,485
Medicaid	422,783	243,371
Other third-party payers	1,624,719	1,925,352
Patients	2,117,419	2,491,518
	<u>5,044,424</u>	<u>5,523,726</u>
Less allowance for uncollectible accounts	<u>1,568,240</u>	<u>2,179,669</u>
	<u><u>\$ 3,476,184</u></u>	<u><u>\$ 3,344,057</u></u>

Note 5: Capital Assets

Capital assets activity for the years ended December 31 was:

	2016				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Hospital					
Land and improvements	\$ 1,042,227	\$ -	\$ -	\$ -	\$ 1,042,227
Buildings and leasehold improvements	19,179,644	-	-	-	19,179,644
Equipment	16,668,198	1,779,934	-	-	18,448,132
Construction in progress	40,282	704,841	-	-	745,123
	<u>36,930,351</u>	<u>2,484,775</u>	<u>-</u>	<u>-</u>	<u>39,415,126</u>
Less accumulated depreciation:					
Buildings and leasehold improvements	11,564,908	807,882	-	-	12,372,790
Equipment	11,779,971	874,338	-	-	12,654,309
	<u>23,344,879</u>	<u>1,682,220</u>	<u>-</u>	<u>-</u>	<u>25,027,099</u>
Total Hospital capital assets, net	<u><u>\$ 13,585,472</u></u>	<u><u>\$ 802,555</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 14,388,027</u></u>

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

	2015				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Hospital					
Land and improvements	\$ 1,042,227	\$ -	\$ -	\$ -	\$ 1,042,227
Buildings and leasehold improvements	19,046,178	133,466	-	-	19,179,644
Equipment	15,539,750	1,128,448	-	-	16,668,198
Construction in progress	-	40,282	-	-	40,282
	<u>35,628,155</u>	<u>1,302,196</u>	<u>-</u>	<u>-</u>	<u>36,930,351</u>
Less accumulated depreciation:					
Buildings and leasehold improvements	10,767,649	797,259	-	-	11,564,908
Equipment	10,935,249	844,722	-	-	11,779,971
	<u>21,702,898</u>	<u>1,641,981</u>	<u>-</u>	<u>-</u>	<u>23,344,879</u>
Total Hospital capital assets, net	<u>\$ 13,925,257</u>	<u>\$ (339,785)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,585,472</u>

Note 6: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claims costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 7: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of \$1,000,000, and an individual policy maximum of \$75,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims, and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Activity in the Hospital's accrued employee health claims liability during 2016 and 2015 is summarized as follows:

	2016	2015
Balance, beginning of year	\$ 256,362	\$ 232,223
Current year claims incurred and changes in estimates for claims incurred in prior years	2,451,810	1,740,893
Claims and expenses paid	<u>(2,383,181)</u>	<u>(1,716,754)</u>
Balance, end of year	<u><u>\$ 324,991</u></u>	<u><u>\$ 256,362</u></u>

Note 8: Pension Plan

The Hospital and MSO Clinics contribute to defined-contribution pension plans covering substantially all employees following one year of service. Pension expense is recorded for the amount of the employer's required contributions, determined in accordance with the terms of the plans. The Hospital plans are administered by a board of trustees appointed by the Hospital Board. The MSO Clinics plan is administered by its governing body. The plans provide retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan documents and were established and can be amended by action of the Hospital's governing body. Plan members may contribute up to \$18,000 of their annual covered salary. The Hospital and MSO Clinics are required to match one-half of the employee contribution up to 5% of employee's compensation. In addition, the Hospital contributes 2% of the annual covered payroll for all eligible active participants. The MSO Clinics may make a discretionary contribution as determined by its governing body. Expense related to employer contributions to the plans was \$268,559 for 2016 and \$251,507 for 2015. The Hospital had accrued benefits payable to the plan of \$170,459 at December 31, 2016 compared to \$156,166 as of December 31, 2015.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Note 9: Operating Leases

A noncancellable operating lease for primary care outpatient office space began in October 2013 and expires in October 2018. This lease contains renewal options for five year periods and requires the Hospital to pay all executory costs (property taxes, maintenance and insurance). Rental expense for operating leases during 2016 and 2015 were \$323,247 and \$324,248, respectively. Future minimum lease payments at December 31, 2016 were:

2017	\$ 220,486
2018	<u>165,364</u>
	<u>\$ 385,850</u>

Note 10: Contingencies

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Commitments

During 2016, the Hospital commenced implementation of a revised master facility plan that includes construction and renovation of certain Hospital facilities. The master facility plan includes significant renovations to certain existing facilities within the Hospital, and construction of dialysis and behavior health buildings.

As part of these significant renovations, improvement and additions, the Hospital entered into various contracts as of year-end for the necessary work to be performed. The total cost of the project is expected to be approximately \$6.3 million, with approximately \$750,000 incurred through December 31, 2016.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Note 11: Investment in Equity Investee

The Hospital invested \$51,000 for a 51% ownership of Sullivan County Community Hospital Pain Management, LLC (Pain Management). The Hospital's investment at December 31, 2016 was \$(12,825), which represents its share of operating losses and is recorded in prepaid expenses and other current assets. The Hospital provides support to the joint venture through labor and supply costs which are billed to Pain Management on a monthly basis. Amounts due from Pain Management totaling \$125,162 are included in prepaid expenses and other current assets at December 31, 2016. The Hospital also provides billing and collection services for Pain Management and remits patient collections to the joint venture to satisfy operating expenses. Amounts due to Pain Management totaling \$143,512 are included in accrued expenses at December 1, 2016. Financial positions and results of operations of the investee are summarized below.

	2016
Current assets	\$ 26,129
Patient billings and receipts due from Sullivan County Community Hospital	143,512
Total assets	<u>169,641</u>
Current liabilities	69,625
Advances payable to Sullivan County Community Hospital	125,162
Total liabilities	<u>194,787</u>
Net assets	<u>\$ (25,146)</u>
Revenues	\$ 369,641
Deficiency of revenues over expenses	\$ (125,146)

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Note 12: Combining Financial Statement Information and Blended Component Unit

The Hospital's combining financial statement information, including that of its blended component unit was summarized as follows for the years ended December 31, 2016 and 2015:

Combining Balance Sheets as of December 31, 2016 and 2015

	2016			2015		
	Hospital	MSO Clinics	Total	Hospital	MSO Clinics	Total
Assets						
Current Assets						
Cash	\$ 3,821,218	\$ 35,118	\$ 3,856,336	\$ 5,750,672	\$ 98,932	\$ 5,849,604
Patient accounts receivable, net of allowance						
2016 - \$1,568,240, 2015 - \$2,179,669	3,074,275	401,909	3,476,184	2,865,762	478,295	3,344,057
Supplies	543,563	129,261	672,824	521,708	97,907	619,615
Estimated amounts due from						
third-party payers	1,263,519	-	1,263,519	-	-	-
Prepaid expenses and other current assets	645,495	-	645,495	450,817	-	450,817
Total current assets	9,348,070	566,288	9,914,358	9,588,959	675,134	10,264,093
Noncurrent Investments - funded						
depreciation	11,091,706	-	11,091,706	11,037,515	-	11,037,515
Capital Assets	13,216,239	1,171,788	14,388,027	12,328,803	1,256,669	13,585,472
Total assets	<u>\$ 33,656,015</u>	<u>\$ 1,738,076</u>	<u>\$ 35,394,091</u>	<u>\$ 32,955,277</u>	<u>\$ 1,931,803</u>	<u>\$ 34,887,080</u>
Liabilities and Net Position						
Current Liabilities						
Accounts payable	\$ 1,209,093	\$ -	\$ 1,209,093	\$ 895,422	\$ -	\$ 895,422
Accrued expenses	2,045,462	108,676	2,154,138	1,658,996	85,235	1,744,231
Estimated amounts due to						
third-party payers	180,403	-	180,403	119,840	-	119,840
Total current liabilities	3,434,958	108,676	3,543,634	2,674,258	85,235	2,759,493
Net Position						
Net investment in capital assets	13,216,239	1,171,788	14,388,027	12,328,803	1,256,669	13,585,472
Unrestricted	17,004,818	457,612	17,462,430	17,952,216	589,899	18,542,115
Total net position	30,221,057	1,629,400	31,850,457	30,281,019	1,846,568	32,127,587
Total liabilities and net position	<u>\$ 33,656,015</u>	<u>\$ 1,738,076</u>	<u>\$ 35,394,091</u>	<u>\$ 32,955,277</u>	<u>\$ 1,931,803</u>	<u>\$ 34,887,080</u>

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2016 and 2015

Combining Statements of Revenues, Expenses and Changes in Net Position for the Years Ended December 31, 2016 and 2015

	2016			2015		
	Hospital	MSO Clinics	Total	Hospital	MSO Clinics	Total
Operating Revenues						
Net patient service revenue, net of provision for uncollectible accounts of 2016 - \$2,039,874; 2015 - \$3,576,647	\$ 26,732,371	\$ 5,200,095	\$ 31,932,466	\$ 25,793,275	\$ 4,615,093	\$ 30,408,368
Other	157,329	-	157,329	200,487	-	200,487
Total operating revenues	<u>26,889,700</u>	<u>5,200,095</u>	<u>32,089,795</u>	<u>25,993,762</u>	<u>4,615,093</u>	<u>30,608,855</u>
Operating Expenses						
Salaries and wages	11,072,101	4,369,200	15,441,301	10,599,905	4,001,832	14,601,737
Employee benefits	3,831,524	691,234	4,522,758	3,013,080	750,127	3,763,207
Purchased services and professional fees	3,555,252	551,862	4,107,114	3,531,970	518,461	4,050,431
Supplies	2,409,218	481,633	2,890,851	2,423,546	367,204	2,790,750
Utilities	406,911	36,941	443,852	392,274	23,621	415,895
Repair and maintenance	1,374,025	19,368	1,393,393	1,143,076	11,352	1,154,428
Leases and rentals	85,134	238,113	323,247	85,884	238,364	324,248
Insurance	351,219	68,681	419,900	361,778	64,626	426,404
Depreciation	1,586,471	95,749	1,682,220	1,542,822	99,159	1,641,981
Other	547,766	95,527	643,293	509,787	76,698	586,485
Provider hospital assessment fee	459,973	-	459,973	521,463	-	521,463
Total operating expenses	<u>25,679,594</u>	<u>6,648,308</u>	<u>32,327,902</u>	<u>24,125,585</u>	<u>6,151,444</u>	<u>30,277,029</u>
Operating Income (Loss)	<u>1,210,106</u>	<u>(1,448,213)</u>	<u>(238,107)</u>	<u>1,868,177</u>	<u>(1,536,351)</u>	<u>331,826</u>
Nonoperating Revenues (Expenses)						
Investment income	57,148	-	57,148	48,551	-	48,551
Other	(96,171)	-	(96,171)	(113,943)	-	(113,943)
Total nonoperating expenses	<u>(39,023)</u>	<u>-</u>	<u>(39,023)</u>	<u>(65,392)</u>	<u>-</u>	<u>(65,392)</u>
Increase (Decrease) in Net Position	<u>1,171,083</u>	<u>(1,448,213)</u>	<u>(277,130)</u>	<u>1,802,785</u>	<u>(1,536,351)</u>	<u>266,434</u>
Transfer From (To) Affiliate	<u>(1,231,045)</u>	<u>1,231,045</u>	<u>-</u>	<u>(1,037,590)</u>	<u>1,037,590</u>	<u>-</u>
Net Position, Beginning of Year	<u>30,281,019</u>	<u>1,846,568</u>	<u>32,127,587</u>	<u>29,515,824</u>	<u>2,345,329</u>	<u>31,861,153</u>
Net Position, End of Year	<u>\$ 30,221,057</u>	<u>\$ 1,629,400</u>	<u>\$ 31,850,457</u>	<u>\$ 30,281,019</u>	<u>\$ 1,846,568</u>	<u>\$ 32,127,587</u>

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

Notes to Financial Statements

December 31, 2016 and 2015

Combining Statements of Cash Flows for the Years Ended December 31, 2016 and 2015

	2016			2015		
	Hospital	MSO Clinics	Total	Hospital	MSO Clinics	Total
Operating Activities						
Receipts from and on behalf of patients	\$ 24,860,929	\$ 5,276,481	\$ 30,137,410	\$ 26,260,306	\$ 5,070,009	\$ 31,330,315
Payments to suppliers and contractors	(8,356,712)	(1,427,952)	(9,784,664)	(7,807,663)	(1,250,961)	(9,058,624)
Payments to employees	(14,642,320)	(5,036,993)	(19,679,313)	(13,909,368)	(4,718,955)	(18,628,323)
Other payments, net	(275,563)	(95,527)	(371,090)	(830,763)	(76,698)	(907,461)
Net cash provided by (used in) operating activities	1,586,334	(1,283,991)	302,343	3,712,512	(976,605)	2,735,907
Noncapital Financing Activity -						
transfer from (to) affiliate	(1,231,045)	1,231,045	-	(1,037,590)	1,037,590	-
Capital and Related Financing Activity -						
purchase of capital assets	(2,140,529)	(10,868)	(2,151,397)	(1,296,229)	(5,967)	(1,302,196)
Investing Activities						
Interest and dividends on investments	57,148	-	57,148	40,591	-	40,591
Purchase of investments	(8,046,001)	-	(8,046,001)	(8,082,788)	-	(8,082,788)
Proceeds from disposition of investments	7,991,810	-	7,991,810	11,066,140	-	11,066,140
Other investing activities	(147,171)	-	(147,171)	(113,943)	-	(113,943)
Net cash provided by (used in) investing activities	(144,214)	-	(144,214)	2,910,000	-	2,910,000
Increase (Decrease) in Cash	(1,929,454)	(63,814)	(1,993,268)	4,288,693	55,018	4,343,711
Cash, Beginning of Year	5,750,672	98,932	5,849,604	1,461,979	43,914	1,505,893
Cash, End of Year	\$ 3,821,218	\$ 35,118	\$ 3,856,336	\$ 5,750,672	\$ 98,932	\$ 5,849,604
Reconciliation of Net Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities						
Operating income (loss)	\$ 1,210,106	\$ (1,448,213)	\$ (238,107)	\$ 1,868,177	\$ (1,536,351)	\$ 331,826
Depreciation	1,586,471	95,749	1,682,220	1,542,822	99,159	1,641,981
Provision for uncollectible accounts	1,926,586	113,288	2,039,874	3,359,037	217,610	3,576,647
Changes in operating assets and liabilities:						
Patient accounts receivable	(2,135,099)	(36,902)	(2,172,001)	(3,197,776)	237,306	(2,960,470)
Estimated amounts due to third-party payers	(1,202,956)	-	(1,202,956)	305,770	-	305,770
Accounts payable and accrued expenses	366,759	23,441	390,200	(168,186)	33,004	(135,182)
Other assets and liabilities	(165,533)	(31,354)	(196,887)	2,668	(27,333)	(24,665)
Net cash provided by (used in) operating activities	\$ 1,586,334	\$ (1,283,991)	\$ 302,343	\$ 3,712,512	\$ (976,605)	\$ 2,735,907

Note 13: Subsequent Events

In April 2017, the Hospital issued revenue bonds in amounts of \$3,900,000 (Series 2017A) and \$1,500,000 (Series 2017B) to fund ongoing construction projects. Interest rates are fixed at 2.87% and 4.10% on Series 2017A and 2017B, respectively. Monthly payments of \$113,750 begin July 2017 with final maturity in April 2032. The bonds are secured by all accounts and deposits of the Hospital as defined in the security agreement.

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Trustees
Sullivan County Community Hospital
Sullivan, Indiana

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Sullivan County Community Hospital (Hospital), which comprise the balance sheet as of December 31, 2016 and the related statements revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 23, 2017.

Internal Control Over Financial Reporting

Management of the Hospital is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the financial statements, we considered the Hospital's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be a material weakness and a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Hospital's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as item 2016-001 to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and responses as item 2016-002 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Management's Response to Findings

The Hospital's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Hospital's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

We also noted certain matters that we reported to the Hospital's management in a separate letter dated May 23, 2017.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Indianapolis, Indiana
May 23, 2017

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Schedule of Findings and Responses
December 31, 2016

Reference Number	Finding
2016-001	Criteria or Specific Requirement: Internal Control Over Financial Reporting Condition: Certain internal controls over financial reporting did not timely detect a material adjustment related to amounts due to and from the Hospital's joint venture. Context: The Hospital provides support and bills the joint venture for certain operating costs. Similarly, the Hospital provides billing and collecting services to the joint venture. Separate financial statements are prepared for the joint venture and the Hospital records amounts due to or from the joint venture for operating expenses and patient billing and collections. The recorded amounts due to the joint venture were not reconciled throughout the year, which led to an adjustment during the audit process. Effect: Potential misstatements in the financial statements could occur and not be detected and/or corrected in a timely manner. Cause: Internal controls and reconciliation of amounts were not adequately applied with respect to amounts due to and from the joint venture. Recommendation: We recommend that management establish a process to reconcile these amounts on a monthly basis. Views of Responsible Officials and Planned Corrective Action: We concur. Management was tracking amounts billed for the joint venture and moved amounts to the due from joint venture account. When cash was received and remitted to the joint venture, contractual adjustments taken were not considered. Management is actively reviewing its processes for the accounting for the joint venture and will reconcile all amounts due to or from the joint venture on a routine basis.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Schedule of Findings and Responses (Continued)
December 31, 2016

Reference Number	Finding
2016-002	Criteria or Specific Requirement: Internal Control Over Financial Reporting Condition: Certain internal controls over financial reporting did not timely detect a material adjustment related to the estimation of patient accounts receivable and amounts due to and from third-party payers. Context: Effective valuation of patient accounts receivable for a health care provider is a complex concept. The estimation of reserves for contractual allowances and uncollectible accounts requires disciplined modeling. Management utilized hindsight analysis to establish reserve rates for outstanding receivable amounts. These reserve rates were not applied to unbilled patient balances, resulting in a significant adjustment during the audit process. Similarly, the estimation of amounts due to or from the Medicare program for the year-end cost report filing requires routine monitoring and evaluation as changes in cost and volumes can materially affect reimbursement under cost-based principles. Management utilized an estimation model to determine amounts due to or from the program which did consider reimbursable Medicare bad debts. An adjustments was recorded during the audit process to account for these bad debts, which can be claimed on the cost report. Effect: Potential misstatements in the financial statements could occur and not be detected and/or corrected in a timely manner. Cause: Internal controls were not adequately applied with respect to patient accounts receivable valuation and estimation of amounts due to or from third-party payers. Recommendation: We recommend that management review models for patient accounts receivable valuation and estimated amounts due to and from third party payers to ensure that balances reflect amounts expected to be collected or remitted. Views of Responsible Officials and Planned Corrective Action: We concur. Management has changed methodologies for both accounts receivable valuation and estimation of amounts due to or from third-party payers. These models will be updated to consider the items noted above and reviewed on an ongoing basis.