Daviess Community Hospital
A Component Unit of Daviess County, Indiana

Auditor's Report and Financial Statements

December 31, 2012

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A Component Unit of Daviess County, Indiana
December 31, 2012

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Independent Auditor's Report on Financial Statements and Supplementary and Other Information

Board of Governors
Daviess Community Hospital
Washington, Indiana

We have audited the accompanying financial statements of Daviess Community Hospital, a component unit of Daviess County, Indiana, which comprise the balance sheet as of December 31, 2012, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements.

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 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 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Daviess Community Hospital as of December 31, 2012, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis 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 Information

Our audit was performed for the purpose of forming an opinion on the basic financial statements as a whole. The accompanying detailed balance sheet information and detailed statement of revenues, expenses and changes in net position information listed in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and accordingly, we do not express an opinion or provide any assurance on it.

BKD, LLP

Indianapolis, Indiana
October 11, 2013

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Management's Discussion and Analysis
Year Ended December 31, 2012

Introduction

This management's discussion and analysis of the financial performance of Daviess Community Hospital, a component unit of Daviess County, Indiana (Hospital), provides an overview of the Hospital's financial activities for the years ended December 31, 2012 and 2011. It should be read in conjunction with the accompanying financial statements of the Hospital. Unless otherwise indicated, amounts are in thousands.

Financial Highlights

- Cash and investments increased in 2012 by $393,807, or 5.2%.
- The Hospital's net position decreased in 2012 by $1,789,162 or 5.9%.
- The Hospital reported operating losses in 2012 of $474,316 and 2011 of $1,627,371 (after reclassifying interest expense in 2011 from an operating expense to nonoperating expense). The operating loss in 2012 decreased by $1,153,055 or 70.9% over the operating loss reported in 2011.
- Net nonoperating expenses decreased by $88,643 or 6.2% in 2012 compared to 2011.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net position; and a statement 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.

Balance Sheet and Statement 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 Sheet and the Statement 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 net position. 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 is 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.

Statement of Cash Flows

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash resulting from our 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.

Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the balance sheet. The Hospital's net position decreased by $1,789,162 (5.9%) in 2012 over 2011, as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2012	2011
Assets		
Patient accounts receivable, net	$ 6,340,617	$ 6,173,124
Other current assets	6,402,934	6,215,568
Capital assets, net	32,231,984	33,589,977
Other noncurrent assets	6,036,477	5,671,169
Total assets	$ 51,012,012	$ 51,649,838
Liabilities		
Long-term debt (including current portion)	$ 17,181,279	$ 16,544,680
Other current and noncurrent liabilities	5,048,930	4,534,193
Total liabilities	22,230,209	21,078,873
Net Position		
Net investment in capital assets	15,050,705	17,045,297
Restricted for debt service	3,118,909	2,353,072
Unrestricted	10,612,189	11,172,596
Total net position	28,781,803	30,570,965
Total liabilities and net position	$ 51,012,012	$ 51,649,838

There were no significant changes in the Hospital's assets in 2012. Other current assets increased by $187,366 (3.0%) primarily as the result of additional funds owed to the Hospital as of December 31, 2012 associated with Indiana's supplemental Medicaid programs. Capital assets decreased by $1,357,993 primarily as a result of depreciation expense during the year that exceeded new acquisitions.

Operating Results and Changes in the Hospital's Net Position

In 2012, the Hospital's net position decreased by $1,789,162 or 5.9% as shown in Table 2. This decrease is made up of several different components and represents an improvement of 46.6% compared with the decrease in net position for 2011 of $3,063,867. Of note, during 2012, the Hospital received approximately $1.8 million of revenue from electronic health records incentive funding.

Table 2: Operating Results and Changes in Net Position

	2012	2011
Operating Revenues		
Net patient service revenue	$ 49,771,392	$ 41,990,552
Other operating revenues	2,480,529	818,062
Total operating revenues	52,251,921	42,808,614
Operating Expenses		
Salaries, wages and employee benefits	27,891,408	25,051,831
Purchased services and professional fees	6,326,976	6,699,756
Depreciation and amortization	3,284,187	2,958,546
Provider hospital assessment fee	4,536,002	-
Other operating expenses	10,687,664	9,725,852
Total operating expenses	52,726,237	44,435,985
Operating Loss	(474,316)	(1,627,371)
Nonoperating Revenues (Expenses)		
Investment income	23,074	36,537
Interest expense	(1,264,776)	(1,626,413)
Other nonoperating revenues and expenses, net	(106,151)	153,380
Total nonoperating expenses	(1,347,853)	(1,436,496)
Capital Grants and Contributions	33,007	-
Decrease in Net Position	$ (1,789,162)	$ (3,063,867)

Operating Losses

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. In each of the past two years, the Hospital has reported an operating loss. This is consistent with the Hospital's recent operating history as the Hospital was formed and is operated primarily to serve residents of Daviess and the surrounding area.

The operating loss for 2012 decreased by $1,153,055 or 71% as compared to 2011. The primary components of the decreased operating loss are:

- A increase in net patient service revenue of $7,780,840 or 18.5%.
- An increase in salaries, wages and benefits for the Hospital's employees of $2,839,577 or 11.3%.
- An increase of electronic health records funding of approximately $1.8 million.
- An increase in provider hospital assessment fees of $4,536,002 for Indiana's new Medicaid provider assessment program as discussed in the attached notes to the financial statements.

During 2012, Indiana implemented a new supplemental payment mechanism for the Medicaid program. This change resulted in additional patient revenue of approximately $4.8 million. This increase was partially offset by the additional provider fee assessment fee of $4.5 million paid beginning in 2012, which is reflected as an operating expense as noted above. Approximately $1.8 million of the increase in other operating revenues is the result of Medicare and Medicaid electronic health records payments received during the year as described in the attached notes.

Employee salaries and wages and benefits increased in 2012 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.

The operating loss for 2012 of $474,316 was a significant improvement compared to the operating loss of $1,627,371 recognized in 2011. Much of this improvement was the result of funds received from Medicare and Medicaid in connection with electronic health records funding received beginning in 2012.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income and interest expense. The Hospital recognized a decrease in interest expense in 2012 as compared to 2011, resulting primarily from more favorable rates on the bonds that were refunded in May 2011.

Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating losses and nonoperating revenues and expenses for 2012 and 2011, discussed earlier.

Capital Asset and Debt Administration

Capital Assets

At the end of 2012, the Hospital had $32,231,984 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. In 2012, the Hospital purchased new furnishings and equipment costing $2,053,092.

Debt

At December 31, 2012, the Hospital had $20,135,000 in revenue bonds outstanding. The Hospital issued no new debt in 2012. The Hospital's formal revenue bonds are subject to limitations imposed by state law.

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 Business Administration by telephoning 812.254.2760.

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Balance Sheet
December 31, 2012

Assets

Current Assets		
Cash	$ 2,769,078	
Patient accounts receivable, net of allowance of $1,594,653	6,340,617	
Supplies	1,136,722	
Prepaid expenses and other	2,497,134	
Total current assets		$ 12,743,551
Noncurrent Cash and Investments		
Internally designated	2,149,526	
Held by trustee for debt service	3,118,909	
		5,268,435
Capital Assets, net		32,231,984
Other Assets		
Deferred financing costs	344,587	
Other	423,455	
		768,042
Total assets		$ 51,012,012

Liabilities and Net Position

Current Liabilities		
Current maturities of long-term debt	$ 902,865	
Interest payable	489,352	
Accounts payable	1,584,985	
Accrued expenses	2,041,407	
Estimated amounts due to third-party payers	214,160	
Other	719,026	
Total current liabilities		$ 5,951,795
Long-Term Debt		16,278,414
Total liabilities		22,230,209
Net Position		
Net investment in capital assets	15,050,705	
Restricted for debt service	3,118,909	
Unrestricted	10,612,189	
Total net position		28,781,803
Total liabilities and net position		$ 51,012,012

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Statement of Revenues, Expenses and Changes in Net Position
Year Ended December 31, 2012

Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts of $3,387,096	$ 49,771,392	
Other	2,480,529	
Total operating revenues		$ 52,251,921
Operating Expenses		
Salaries and wages	22,127,787	
Employee benefits	5,763,621	
Purchased services and professional fees	6,326,976	
Supplies	5,296,629	
Insurance	508,524	
Utilities	898,354	
Rent	402,712	
Repairs and maintenance	2,349,796	
Provider hospital assessment fee	4,536,002	
Depreciation and amortization	3,284,187	
Other	1,231,649	
Total operating expenses		52,726,237
Operating Loss		(474,316)
Nonoperating Revenues (Expenses)		
Investment income	23,074	
Interest expense	(1,264,776)	
Other	(106,151)	
Total nonoperating expenses		(1,347,853)
Deficiency of Revenues Over Expenses Before Capital Grants and Contributions		(1,822,169)
Capital Grants and Contributions		33,007
Decrease in Net Position		(1,789,162)
Net Position, Beginning of Year		30,570,965
Net Position, End of Year		$ 28,781,803

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Statement of Cash Flows
Year Ended December 31, 2012

Operating Activities		
Receipts from and on behalf of patients	$ 49,818,059	
Payments to suppliers and contractors	(15,650,046)	
Payments to employees	(27,907,585)	
Other receipts (payments), net	(3,287,122)	
Net cash provided by operating activities		$ 2,973,306
Capital and Related Financing Activities		
Capital grants and gifts	33,007	
Principal paid on capital leases	(13,896)	
Interest paid on long-term debt and capital leases	(1,033,640)	
Purchase of capital assets	(1,612,308)	
Other financing activities	130,411	
Net cash used in capital and related financing activities		(2,496,426)
Investing Activities		
Interest and dividends on investments	23,074	
Purchase of investments	(767,428)	
Other investing activities	(106,151)	
Net cash used in investing activities		(850,505)
Decrease in Cash		(373,625)
Cash, Beginning of Year		3,142,703
Cash, End of Year		$ 2,769,078
Reconciliation of Net Operating Loss to Net Cash Provided by Operating Activities		
Operating loss		$ (474,316)
Depreciation and amortization		3,284,187
Provision for uncollectible accounts		3,387,096
Changes in operating assets and liabilities:		
Patient accounts receivable		(3,554,589)
Estimated amounts due from and to third-party payers		214,160
Accounts payable and accrued expenses		300,577
Other assets and liabilities		(183,809)
Net cash provided by operating activities		$ 2,973,306
Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets		$ 440,784

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Notes to Financial Statements
December 31, 2012

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

Nature of Operations and Reporting Entity

Daviess Community Hospital (Hospital) is an acute care hospital located in Washington, Indiana. The Hospital is a component unit of Daviess County (County) and the Board of County Commissioners appoints members to the Board of Governors 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 Daviess County area. It also operates a home health agency in the same geographic area.

In accordance with this statement, the financial statements include the financial statements of the Daviess Community Hospital Foundation (Foundation). The Foundation's purpose is to provide philanthropic support through fundraising and other activities for the acquisition of equipment, facility development and support of programs at the Hospital, and has therefore been reported as a blended component unit.

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, while those from government-mandated nonexchange transactions (principally state grants and county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses.

During 2012, the Hospital adopted Statement of Governmental Accounting Standards Board (GASB) No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that Statement to apply post-November 30, 1989, FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. This Statement has been applied retrospectively and had no impact on the Hospital's net position, changes in net position or financial reporting disclosures.

During 2012, the Hospital also adopted Statement of Governmental Accounting Standards Board (GASB) No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement has been applied retrospectively and had no impact on the Hospital's net position, changes in net position or financial reporting disclosures other than changing terminology from net assets to net position.

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.

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 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. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income for 2012 includes dividend and interest income.

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. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	5-25 years
Buildings and leasehold improvements	5-40 years
Equipment	3-20 years

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

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 when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. 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 is 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 three 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. The restricted component of net position is noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net position is the remaining assets less remaining liabilities that do not meet the definition of investment in capital assets, or restricted.

Net position of the Foundation is classified as unrestricted or restricted. Restricted net position is that whose use by the Foundation has been limited by donors to a specific time period or purpose.

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 $1,383,333 for 2012.

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. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

The Foundation 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, the Foundation is subject to federal income tax on any unrelated business taxable income. The Foundation files federal tax returns in the U.S. federal jurisdiction.

Foundation

Hospital Foundation, Inc. (Foundation) is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs. The board of the Foundation is self-perpetuating.

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). Payments under the Medicare program are generally made for up to four years based on a statutory formula. 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. Payment under both programs are contingent on the hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year 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 recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2012, the Hospital completed the first-year requirements under both the Medicare and Medicaid programs and has recorded revenue of approximately $1.8 million, which is included in other operating revenues in the statement of revenues, expenses and changes in net position.

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. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. Certain inpatient nonacute services are paid based on a cost reimbursement methodology. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of 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 very according to the service provided and the patient diagnosis.

Approximately 40% of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the year ended December 31, 2012. 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 received approximately $4.8 million during 2012 due to the enactment of a state specific provider assessment program to increase Medicaid payments to hospitals. This revenue is recorded within net patient service revenue in the statement of revenues, expenses and changes in net position for 2012. Approximately $1.6 million of these increased payments were related to the Hospital's fiscal year 2011. The Hospital paid approximately $4.5 million into this Medicaid program, which is recorded as an operating expense in the statement of revenues, expenses and changes in net position. Approximately $1.5 million of the payments to the Medicaid program were related to the Hospital's fiscal year 2011, but are included in 2012 as a result of when the assessment program was approved. There is no assurance this program will continue to be implemented in the future.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations 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 Depository 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.

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 and in bank repurchase agreements. It may also invest to a limited extent in certain deposit accounts, mutual funds, repurchase agreements and pooled investment funds as authorized by Indiana Code 16-22-3-20.

At December 31, 2012, the Hospital had the following investments and maturities:

	December 31, 2012				
		Maturities in Years			
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
Money market mutual funds	$ 3,215,120	$ 3,215,120	$ -	$ -	$ -

Interest Rate Risk - Interest rate risk is the risk that the changes in interest rates will adversely affect the fair value of an investment. The Hospital does not have a formal investment policy for interest rate risk.

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. The Hospital does not have a formal investment policy for credit risk. At December 31, 2012, the Hospital's investments were not rated.

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 and investments shown above are included in the balance sheet as follows:

	2012
Carrying value:	
Deposits	$ 4,822,393
Investments	3,215,120
	$ 8,037,513
Included in the following balance sheet captions:	
Cash	$ 2,769,078
Noncurrent cash and investments	5,268,435
	$ 8,037,513

Investment Income

Investment income for the year ended December 31 consisted of:

	2012
Interest and dividend income	$ 23,074

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:

	2012
Medicare	$ 1,909,762
Medicaid	968,562
Other third-party payers	2,312,662
Patients	2,744,284
	7,935,270
Less allowance for uncollectible accounts	1,594,653
	$ 6,340,617

Note 5: Capital Assets

	2012				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 1,280,955	$ -	$ -	$ -	$ 1,280,955
Land improvements	687,865	-	-	-	687,865
Buildings and leasehold improvements	38,448,591	134,533	-	-	38,583,124
Equipment	27,859,643	1,918,559	(719,639)	129,796	29,188,359
Construction in progress	131,561	-	-	(129,796)	1,765
	68,408,615	2,053,092	(719,639)	-	69,742,068
Less accumulated depreciation:					
Land improvements	431,085	227,467	(32,928)	-	625,624
Buildings and leasehold improvements	14,506,074	1,042,772	(3,898)	-	15,544,948
Equipment	19,881,479	2,010,435	(552,402)	-	21,339,512
	34,818,638	3,280,674	(589,228)	-	37,510,084
Capital assets, net	$ 33,589,977	$ (1,227,582)	$ (130,411)	$ -	$ 32,231,984

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 claim 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 $80,000 per enrollee. 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.

Activity in the Hospital's accrued employee health claims liability during 2012 is summarized as follows:

	2012
Balance, beginning of year	$ 228,979
Current year claims incurred and changes in estimate	3,690,232
Claims and expenses paid	(3,519,211)
Balance, end of year	$ 400,000

Note 8: Long-Term Debt

The following is a summary of long-term obligation transactions for the Hospital for the year ended December 31:

	2012				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt:					
Series 2011 refunding revenue bonds	$ 20,135,000	$ -	$ -	$ 20,135,000	$ 820,000
Deferred amounts					
Plus: bond premium	79,809	-	(4,671)	75,138	-
Less: loss on refunding	(3,670,129)	-	214,382	(3,455,747)	-
Capital lease obligations	-	440,784	(13,896)	426,888	82,865
Total long-term debt	$ 16,544,680	$ 440,784	$ 195,815	$ 17,181,279	$ 902,865

Series 2011 Revenue Refunding Bonds Payable

The Series 2011 revenue refunding bonds payable consist of lease rental revenue bonds (bonds) in the original amount of $20,135,000 dated May 2011, which bear interest at 3% to 5.25%. Beginning in 2013, the bonds are payable in annual installments through January 15, 2029. The Hospital is required to make monthly deposits to the debt service fund held by the trustee, and interest payments are payable January 15th and July 15th annually. The bonds are secured by the net revenues and accounts receivable of the Hospital and the assets restricted under the bond indenture agreement.

The debt service requirements as of December 31, 2012 are as follows:

Year Ending December 31,	Total to be Paid	Principal	Interest
2013	$ 1,782,325	$ 820,000	$ 962,325
2014	1,777,425	840,000	937,425
2015	1,773,075	870,000	903,075
2016	1,768,575	910,000	858,575
2017	1,775,305	955,000	820,305
2018-2022	8,846,575	5,455,000	3,391,575
2023-2027	8,783,063	6,960,000	1,823,063
2028-2029	3,501,794	3,325,000	176,794
	$ 30,008,137	$ 20,135,000	$ 9,873,137

Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. The following is a schedule by year of future minimum lease payments under the capital lease including interest at a rate of 4.25% together with the present value of the future minimum lease payments as of December 31, 2012:

2013	$ 99,406
2014	99,406
2015	99,406
2016	99,406
2017	74,555
Total minimum lease payments	472,179
Less amount representing interest	45,291
Present value of future minimum lease payments	$ 426,888

Assets under capital leases at December 31, 2012, totaled:

Machinery and equipment	$ 440,784
Accumulated depreciation	(48,211)
	$ 392,573

Note 9: Pension Plan

The Hospital contributes to a defined-contribution 403(b) pension plan covering substantially all employees after one year of service. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by a board of governors. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's board of governors. The Hospital will match 50% of the employee's contributions into the plan up to a maximum of 4% contribution by the employee. Employees are 100% vested in their own contributions and are vested on an increasing scale from 0% to 100% over 5 years in Hospital contributions. Hospital contributions aggregated $161,302 during 2012.

Note 10: Risks and Uncertainties

Current Economic Conditions

The current economic environment presents hospitals with unprecedented circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments and other assets, large declines in contributions, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values and allowances for accounts and contributions receivable that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.

Note 11: Contingencies

Investigation

The Hospital is performing an internal investigation regarding specific third-party payer program billing issues. Management believes the Hospital's medical records fully support the codes used and billings submitted and intends to vigorously defend the Hospital should any assertions to the contrary be made. No provision has been made in the financial statements for any adverse outcome that might ultimately result from this matter, as the amount of any such loss is not reasonably estimable. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

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.

Note 12: Patient Protection and Affordable Care Act

The Patient Protection and Affordable Care Act (PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which will provide individuals without employer provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible that the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional.

The state of Indiana has not affirmatively indicated whether or not it will participate in the expansion of the Medicaid program. The impact of that decision on the overall reimbursement to the Hospital cannot be quantified at this point.

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible that it will have a negative impact on the Hospital's net patient service revenue. Additionally, it is possible the Hospital will experience payment delays and other operational challenges during PPACA's implementation.

Other Information

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Detailed Balance Sheet Information
December 31, 2012

	2012		
Assets	Hospital	Hospital Foundation	Total
Current Assets			
Cash	$ 2,707,691	$ 61,387	$ 2,769,078
Patient accounts receivable, net of allowance of $1,594,653	6,340,617	-	6,340,617
Supplies	1,136,722	-	1,136,722
Prepaid expenses and other	2,497,134	-	2,497,134
Total current assets	12,682,164	61,387	12,743,551
Noncurrent Cash and Investments			
Internally designated	1,596,852	552,674	2,149,526
Held by trustee for debt service	3,118,909	-	3,118,909
	4,715,761	552,674	5,268,435
Capital Assets, net	32,231,984	-	32,231,984
Other Assets			
Deferred financing costs	344,587	-	344,587
Other	423,455	-	423,455
	768,042	-	768,042
Total assets	$ 50,397,951	$ 614,061	$ 51,012,012
Liabilities and Net Position			
Current Liabilities			
Current maturities of long-term debt	$ 902,865	$ -	$ 902,865
Interest payable	489,352	-	489,352
Accounts payable	1,584,985	-	1,584,985
Accrued expenses	2,041,407	-	2,041,407
Estimated amounts due to third-party payers	214,160	-	214,160
Other	719,026	-	719,026
Total current liabilities	5,951,795	-	5,951,795
Long-Term Debt	16,278,414	-	16,278,414
Total liabilities	22,230,209	-	22,230,209
Net Position			
Net investment in capital assets	15,050,705	-	15,050,705
Restricted for debt service	3,118,909	-	3,118,909
Unrestricted	9,998,128	614,061	10,612,189
Total net position	28,167,742	614,061	28,781,803
Total liabilities and net position	$ 50,397,951	$ 614,061	$ 51,012,012

Daviess Community Hospital
A Component Unit of Daviess County, Indiana
Detailed Statement of Revenues, Expenses and Changes in Net Position Information
Year Ended December 31, 2012

	Hospital	Foundation	Total
Operating Revenues			
Net patient service revenue, net of provision for uncollectible accounts of $3,387,096	$ 49,771,392	$ -	$ 49,771,392
Other	2,480,529	-	2,480,529
Total operating revenues	52,251,921	-	52,251,921
Operating Expenses			
Salaries and wages	22,127,787	-	22,127,787
Employee benefits	5,763,621	-	5,763,621
Purchased services and professional fees	6,324,081	2,895	6,326,976
Supplies	5,291,016	5,613	5,296,629
Insurance	508,524	-	508,524
Utilities	898,354	-	898,354
Rent	402,712	-	402,712
Repairs and maintenance	2,349,796	-	2,349,796
Provider hospital assessment fee	4,536,002	-	4,536,002
Depreciation and amortization	3,284,187	-	3,284,187
Other	1,207,349	24,300	1,231,649
Total operating expenses	52,693,429	32,808	52,726,237
Operating Loss	(441,508)	(32,808)	(474,316)
Nonoperating Revenues (Expenses)			
Investment income	21,489	1,585	23,074
Interest expense	(1,264,776)	-	(1,264,776)
Other	(106,151)	-	(106,151)
Total nonoperating revenues (expenses)	(1,349,438)	1,585	(1,347,853)
Deficiency of Revenues Over Expenses Before Capital Grants and Contributions	(1,790,946)	(31,223)	(1,822,169)
Capital Grants and Contributions	-	33,007	33,007
Increase (Decrease) in Net Position	(1,790,946)	1,784	(1,789,162)
Net Position, Beginning of Year	29,958,688	612,277	30,570,965
Net Position, End of Year	$ 28,167,742	$ 614,061	$ 28,781,803