



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

B44679

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2765

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

January 9, 2015

Board of Directors
Perry County Memorial Hospital
One Hospital Road
Tell City, IN 47586

We have reviewed the audit report prepared by Dean Dorton Allen Ford, PLLC, Independent Public Accountants, for the period January 1, 2013 to December 31, 2013. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Perry County Memorial Hospital, as of December 31, 2013 and the results of its operations for the period then ended, on the basis of accounting described in the report.

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

We call your attention to the findings in the report. The report disclosed three audit findings. See the Schedule of Findings and Questioned Costs for complete details related to the findings. Management's responses and planned corrective action directly follow each finding.

Paul D. Joyce
Paul D. Joyce, CPA
State Examiner

**PERRY COUNTY MEMORIAL
HOSPITAL**

**Financial Statements and Single Audit Reports Under
OMB Circular A-133**

*Year Ended December 31, 2013
with Report of Independent Auditors*

CONTENTS

	<u>Pages</u>
Report of Independent Auditors.....	1 - 3
Financial Statements and Notes to the Financial Statements.....	4 - 22
Combining Information:	
Combining Balance Sheet.....	23 - 24
Combining Statement of Operations and Changes in Net Assets.....	25
Schedule of Expenditures of Federal Awards.....	26
Notes to the Schedule of Expenditures of Federal Awards.....	27
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	28 - 29
Report on Compliance for Each Major Program and Report on Internal Control Over Compliance Required by OMB Circular A-133.....	30 - 31
Schedule of Findings and Questioned Costs.....	32 - 35

Report of Independent Auditors

Board of Trustees
Perry County Memorial Hospital
Tell City, Indiana

Report on the Financial Statements

We have audited the accompanying combined financial statements of Perry County Memorial Hospital (the Hospital) which comprise the combined balance sheet as of December 31, 2013, and the related combined statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined financial statements based on our audit. We conducted our audit 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of Perry County Memorial Hospital as of December 31, 2013, and the changes in net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Combining Information

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The combining information on pages 23 - 25 is presented for purposes of additional analysis of the combined financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities and is not a required part of the combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The combining information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining information is fairly stated in all material respects in relation to the combined financial statements as a whole.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The *Schedule of Expenditures of Federal Awards, as required by Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations* is presented for purposes of additional analysis and is not a required part of the combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the combined financial statements as a whole.

Board of Trustees
Perry County Memorial Hospital
Report of Independent Auditors, continued

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 8, 2014 on our consideration of the Hospital's internal control over financial reporting and on 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.

Dean Dotson Allen Ford, PLLC

September 8, 2014
Louisville, Kentucky

PERRY COUNTY MEMORIAL HOSPITAL

Combined Balance Sheets

December 31, 2013 and 2012

Assets	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Current assets:		
Cash and cash equivalents	\$ 3,767,957	\$ 5,761,165
Investments	10,793,898	9,820,499
Patient accounts receivable, net of estimated uncollectibles of approximately \$3,273,000 and \$3,665,000, respectively	6,050,390	6,525,153
Other accounts receivable	82,745	59,384
Inventories	766,958	709,823
Prepaid expenses and other current assets	<u>605,730</u>	<u>642,599</u>
Total current assets	22,067,678	23,518,623
Assets limited as to use:		
Internally designated for capital acquisition	2,457,232	847,503
Permanently restricted funds	155,000	155,000
Construction funds held by trustee	<u>3,753,625</u>	<u>-</u>
Total assets limited as to use	6,365,857	1,002,503
Property and equipment, net	24,673,574	14,962,319
Other assets	<u>76,576</u>	<u>25,000</u>
Total assets	<u>\$ 53,183,685</u>	<u>\$ 39,508,445</u>

Liabilities and Net Assets	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Current liabilities:		
Accounts payable	735,185	633,788
Construction payables	4,277,464	-
Accrued payroll	1,567,772	1,437,265
Other accrued expenses	761,316	259,678
Estimated third-party payor settlements	2,030,000	820,000
Current portion of long-term debt	<u>144,801</u>	<u>450,795</u>
Total current liabilities	9,516,538	3,601,526
Long-term debt, net of current portion	<u>9,305,546</u>	<u>1,185,063</u>
Total liabilities	18,822,084	4,786,589
Net assets:		
Unrestricted	34,206,601	34,566,856
Permanently restricted	<u>155,000</u>	<u>155,000</u>
Total net assets	<u>34,361,601</u>	<u>34,721,856</u>
Total liabilities and net assets	<u>\$ 53,183,685</u>	<u>\$ 39,508,445</u>

See accompanying notes.

PERRY COUNTY MEMORIAL HOSPITAL

Combined Statements of Operations and Change in Net Assets

Years ended December 31, 2013 and 2012

	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Revenues, gains, and other support:		
Net patient service revenue (net of contractual discounts and allowances)	\$ 37,964,359	\$ 38,155,066
Provision for bad debts	<u>(5,216,314)</u>	<u>(5,281,822)</u>
Net patient service revenue less provision for bad debts	32,748,045	32,873,244
Investment income	703,322	541,828
Other revenue	<u>396,412</u>	<u>1,579,065</u>
Total revenues, gains, and other support	33,847,779	34,994,137
Expenses:		
Salaries and other wage costs	17,281,413	16,737,124
Supplies and other expenses	3,329,243	3,712,318
General and administrative expenses	1,775,707	1,689,309
Professional fees	2,323,200	2,149,840
Contracted services	5,986,372	5,749,677
Depreciation and amortization	1,088,609	1,138,089
Provider tax expense	1,564,119	1,564,371
Other direct expenses	1,079,031	946,183
Interest expense	<u>20,787</u>	<u>85,611</u>
Total expenses	<u>34,448,481</u>	<u>33,772,522</u>
(Deficit) excess of revenues over expenses	(600,702)	1,221,615
Change in net unrealized gains and losses on investments	<u>240,447</u>	<u>116,458</u>
(Decrease) increase in net assets	(360,255)	1,338,073
Net assets, beginning of year	<u>34,721,856</u>	<u>33,383,783</u>
Net assets, end of year	<u>\$ 34,361,601</u>	<u>\$ 34,721,856</u>

See accompanying notes.

PERRY COUNTY MEMORIAL HOSPITAL

Combined Statements of Cash Flows

Years ended December 31, 2013 and 2012

	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Cash flows from operating activities:		
(Decrease) increase in net assets	\$ (360,255)	\$ 1,338,073
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	1,088,609	1,138,089
Provision for bad debts	5,216,314	5,281,822
Loss (gain) on sale of property and equipment	65	(5,391)
Unrealized/realized gain on investments, net	(864,738)	(614,681)
Increase (decrease) in cash due to changes in:		
Patient accounts receivable	(4,741,551)	(6,296,432)
Inventories	(57,135)	768,505
Prepaid expenses and other current assets	(38,068)	(642,104)
Accounts payable	101,397	(539,508)
Accrued payroll and other accrued expenses	632,145	674,258
Estimated third party settlements	<u>1,210,000</u>	<u>820,000</u>
Net cash provided by operating activities	2,186,783	1,922,631
Cash flows from investing activities:		
(Increase) decrease in assets limited as to use, net	(5,363,354)	1,054,697
Increase in investments, net	(108,661)	(2,836,802)
Purchases of property and equipment	(6,522,465)	(1,151,165)
Proceeds from sale of property and equipment	<u>-</u>	<u>5,391</u>
Net cash used in investing activities	(11,994,480)	(2,927,879)
Cash flows from financing activities:		
Proceeds from long-term debt	8,120,483	-
Principal payments on long-term debt	<u>(305,994)</u>	<u>(797,257)</u>
Net cash provided by (used in) financing activities	<u>7,814,489</u>	<u>(797,257)</u>
Net decrease in cash	(1,993,208)	(1,802,505)
Cash and cash equivalents, beginning of year	<u>5,761,165</u>	<u>7,563,670</u>
Cash and cash equivalents, end of year	<u>\$ 3,767,957</u>	<u>\$ 5,761,165</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest (net of capitalized interest; see Note 6)	\$ 20,787	\$ 85,611

See accompanying notes.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements

1. Description of the Organization

The accompanying combined financial statements include the transactions and accounts of Perry County Memorial Hospital District (the District), Perry County Memorial Hospital Association and Perry County Memorial Hospital Foundation (collectively, the Hospital). The Hospital operates under a board established in accordance with Indiana County Hospital Law, Indiana Code 16-22. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in Perry County and its surrounding counties.

Although it is legally separate from the Hospital, Perry County Memorial Foundation (the Foundation) is reported if it were a part of the Hospital because it provides services entirely or almost entirely to the Hospital. The Foundation's purpose is to support the Hospital through fundraising drives. The Foundation has been recognized as tax exempt under section 501(c)(3) of the Internal Revenue Code (the Code).

Perry County Memorial Hospital Association (the Association) was created pursuant to the provisions of Indiana Code 16-22-6 for the exclusive purpose of financing and constructing hospital facilities for the Hospital.

2. Summary of Significant Accounting Policies

The combined financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) which require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The following is a summary of the significant accounting policies consistently followed by the Company in the preparation of its financial statements:

Principles of Combination

The combined financial statements include the financial statements of the District, the Association and the Foundation. All significant intercompany accounts and transactions are eliminated in combination.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and other highly liquid resources, such as investments in certificates of deposit and money market funds, with an original maturity of three months or less when purchased. The Hospital routinely invests its surplus operating funds in money market mutual funds. These funds generally invest in highly liquid U.S. government and agency obligations.

At times, balances in the Hospital's cash accounts may exceed federally insured limits. The Hospital has not experienced any losses on such accounts. The Hospital believes it is not exposed to any significant credit risk on cash and cash equivalents.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses.

The Hospital has elected not to further disaggregate the investments as displayed in Notes 3 and 4 as additional risk information is not deemed material to the combined financial statements.

Patient Accounts Receivable

Patient accounts receivable consist of amounts due from government programs (e.g., Medicare and Medicaid) and non-government payors (e.g., self-pay and commercial payors). Management believes there are minimal credit risks associated with the receivables from government programs. Non-government receivables are from various payors that are subject to differing economic conditions. Management continually monitors and adjusts the allowance for uncollectible accounts associated with credit risk of patient accounts receivable.

Inventories

Inventories (principally pharmaceuticals and medical supplies) are stated at the lower of cost (first-in, first-out method) or market.

Assets Limited as to Use

Assets limited as to use include assets held by trustees under debt agreements, assets whose use is restricted by a donor and designated assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes. All the assets consist of cash and cash equivalents.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Property, Plant and Equipment, continued

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity.

(Deficit) Excess of Revenues Over Expenses

The statement of operations includes (deficit) excess of revenues over expenses. Changes in unrestricted net assets which are excluded from (deficit) excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Net Patient Service Revenue

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

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; job related injuries and illnesses to employees; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than medical malpractice. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Compensated Absences

Hospital employees earn sick leave at the rate of 12 days per year. Unused sick leave may be accumulated to a maximum of 30 days. Accumulated sick leave is not paid to employees upon retirement or termination.

Hospital employees earn vacation leave at rates from 5 days to 25 days per year based upon the number of years of service. Accrued vacation may be used upon completion of a 90-day waiting period. It is highly recommended that employees use their allotted vacation time yearly. Unused vacation leave is paid to employees through cash payment upon termination.

Charity Care

The Hospital accepts patients regardless of their ability to pay. A patient is classified as a charity patient based on certain established policies. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Hospital includes certain cases where incurred charges are significant when compared to the patient's income. These charges are not included in net patient service revenue as payment is not expected.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Statutory Authorization for Investments

Indiana Code 16-22-3-20 authorizes the Hospital to invest in any interest bearing account that is authorized to be set up and offered by a financial institution or brokerage firm registered and authorized to do business in Indiana. It also allows the Hospital to repurchase or resale agreements involving the purchase and guaranteed resale of any interest bearing obligations issued or fully insured or guaranteed by the United States of America or any United States government agency in which type of agreement the amount of money must be fully collateralized by interest bearing obligations as determined by the current market value computed on the day the agreement is effective. Mutual funds offered by a financial institution or brokerage firm registered and authorized to do business in Indiana. Securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency. Pooled fund investments for participating hospitals offered, managed, and administered by a financial institution or brokerage firm registered or authorized to do business in Indiana.

Income Taxes

The District and Association are exempt from taxation pursuant to Internal Revenue Code (the Code) Section 115. The Foundation is a not-for-profit organization as described in Section 501(c)(3) of the Code and is exempt from federal income taxes on related income pursuant to 501(a) of the Code. Accordingly, no provision for federal income tax is required. However, the Hospital is subject to federal income tax on any unrelated business taxable income. Management believes they do not have any unrelated business taxable income.

Management has evaluated the Hospital's tax positions and concluded that the Hospital has taken no material uncertain tax positions that require adjustment to the financial statements to comply with the provisions of this guidance. With few exceptions, the Hospital is no longer subject to income tax examinations by U.S. federal, state, or local tax authorities for the years before 2010.

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through September 8, 2014, the date that the combined financial statements were available to be issued.

Prior Year Adjustments and Reclassifications

The financial statements of the District and the Foundation, as of and for the year ended December 31, 2012, were audited by the Indiana State Board of Accounts whose report dated June 26, 2013 expressed an unmodified opinion on those statements. Because the Association's creation is for the exclusive purpose of financing and constructing hospital facilities for the Hospital, GAAP requires that the Association's accounts and financial activity be included in the combined presentation of the Hospital's accounts and financial activity. As such the Association's accounts and financial activity are included in the 2013 combined financial statements.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Prior Year Adjustments and Reclassifications, continued

In order to present comparative financial statements for 2013 and 2012, the 2012 accounts and financial activity of the Association were combined with the audited 2012 financial statements. As such, the presented 2012 financial statements and footnote information of the Hospital are identified as *Unaudited*.

3. Investments

Investments, stated at fair value, at December 31, 2013 and 2012, include:

	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Cash and cash equivalents	\$ 1,642,633	\$ 1,298,104
Certificates of deposit	4,360,604	4,357,468
Accrued interest receivable	3,916	2,474
Mutual funds	<u>4,786,745</u>	<u>4,162,453</u>
	<u>\$ 10,793,898</u>	<u>\$ 9,820,499</u>

Investment income and gains for assets limited as to use and cash equivalents are comprised of the following for the years ended December 31, 2013 and 2012:

	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Investment income:		
Interest and dividends	\$ 79,031	\$ 43,595
Realized gains on sales	624,291	498,233
Unrealized gains	<u>240,447</u>	<u>116,458</u>
	<u>\$ 943,769</u>	<u>\$ 658,286</u>

4. Fair Value Measurements

The Hospital classifies its investments based on a hierarchy consisting of: Level 1 (valued using quoted prices from active markets for identical assets), Level 2 (not traded on an active market but for which observable market inputs are readily available), and Level 3 (valued based on significant unobservable inputs). The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis:

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

4. Fair Value Measurements, continued

Mutual funds: Valued at the daily closing price as reported by the fund. Mutual funds held by the Hospital are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value (NAV) and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.

There have been no changes in the valuation methodologies used at December 31, 2013.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Hospital believes the valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, within the fair value hierarchy, the Hospital's investments at fair value as of December 31:

2013	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Mutual funds	\$ <u>4,786,744</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>4,786,744</u>
Total investments	\$ <u>4,786,744</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>4,786,744</u>
<i>(Unaudited)</i>				
2012	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Mutual funds	\$ <u>4,162,453</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>4,162,453</u>
Total investments	\$ <u>4,162,453</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>4,162,453</u>

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

5. Property and Equipment

Property and equipment consists of the following as of December 31:

	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Land	\$ 2,945,631	\$ 2,945,631
Buildings	10,365,854	10,365,854
Leasehold improvements	1,494,906	1,494,906
Machinery and equipment	15,476,514	15,071,709
Construction in process	<u>15,485,154</u>	<u>5,205,123</u>
	45,768,059	35,083,223
Less accumulated depreciation and amortization	<u>(21,094,485)</u>	<u>(20,120,904)</u>
Property and equipment, net	<u>\$ 24,673,574</u>	<u>\$ 14,962,319</u>

During 2012, the Hospital committed to construction of a new \$51,500,000 hospital building project. Construction in process is primarily related to the project.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

6. Debt

Debt consists of the following as of December 31:

	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
USDA construction loan payable not to exceed \$40,000,000, maturing semi-annually through January 2053 in the form of Perry County Hospital Association Lease Revenue Bonds, Series 2013 with an interest rate not to exceed 3.5%. The interest rate at December 31, 2013 was 3.125%. The bonds are payable semiannually beginning in July 2015 until the maturity date.	\$ 9,140,340	\$ -
Bank note payable, maturing in March 2016, bearing interest at 4.93% as of December 31, 2013, payable in monthly installments of principal and interest of \$3,940 through the maturity date.	104,008	739,089
Mortgage note payable, maturing in June 2016, bearing interest at 4.70% as of December 31, 2013, payable in monthly installments of principal and interest of \$3,940 through the maturity date.	152,820	795,586
Capital lease obligation bearing imputed interest of 2.14%, collateralized by leased equipment with a net book value of \$51,019 at December 31, 2013.	<u>53,179</u>	<u>101,183</u>
	9,450,347	1,635,858
Less: amounts due within one year	<u>144,801</u>	<u>450,795</u>
Long-term portion of debt	<u>\$ 9,305,546</u>	<u>\$ 1,185,063</u>

Under the terms of the USDA loan payable, the Hospital is required to maintain certain deposits with a trustee. Such deposits are included in assets limited as to use. The USDA loan payable also places limits on the incurrence of additional borrowings and requires the Hospital to satisfy certain measures of financial performance as long as the bonds are outstanding.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

6. Debt, continued

Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows:

	<u>Long-Term Debt</u>	<u>Capital Lease Obligation</u>
2014	\$ 101,779	\$ 45,583
2015	389,770	8,261
2016	615,279	-
2017	587,000	-
2018	605,000	-
Thereafter	<u>7,098,340</u>	<u>-</u>
	<u>\$ 9,397,168</u>	53,844
Less amount representing interest under capital leases obligations		<u>665</u>
		<u>\$ 53,179</u>

A summary of interest cost and investment income on borrowed funds held by the trustee under the USDA loan during the years ended December 31 2013 and 2012 are as follows:

	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Interest cost:		
Capitalized	\$ 35,313	\$ -
Charged to operations	<u>20,787</u>	<u>85,611</u>
	<u>\$ 56,100</u>	<u>\$ 85,611</u>
Investment income:		
Capitalized	\$ -	\$ -
Credited to other revenue	<u>-</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ -</u>

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

7. Net Patient Service Revenue

The Hospital has agreements with federal, state and third-party payers that provide for payments at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between billings at established rates and amounts reimbursed by third-party payers. The Hospital participates in the Medicare and Medicaid programs. Approximately 44% and 16%, respectively, of the Hospital's 2013 net patient service revenue was derived from services to patients covered by these programs. Comparable percentages for 2012 (*unaudited*) were 45% and 14%, respectively. Changes in the Medicare and/or Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital. A summary of the payment arrangements with major third-party payers follows:

Hospital

Medicare

The Hospital has been granted Critical Access Hospital (CAH) status by Medicare. Under the CAH designation, services rendered to Medicare program beneficiaries are reimbursed under a cost reimbursement methodology.

Medicaid

The Hospital has been granted CAH status by Medicare. Under the CAH designation, most services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology.

For cost-reimbursed services, the Hospital receives interim payments from Medicare and Medicaid. Final settlements are determined after submission of annual cost reports filed by the Hospital and audit or desk review thereof by Medicare or Medicaid. Management feels that adequate provision has been made for the effects, if any, of audits or desk reviews by either program.

The Hospital has also entered into reimbursement agreements with certain commercial insurance carriers and other organizations. The basis for reimbursement under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per-diem rates.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

7. Net Patient Service Revenue, continued

Following is a summary of gross and net patient service revenue for the years ended December 31:

	<u>2013</u>	<i>(Unaudited)</i> <u>2012</u>
Gross patient service revenue	\$ 73,491,148	\$ 76,118,349
Less provisions for:		
Contractual adjustments under third-party reimbursement programs	33,264,258	35,412,073
Charity care	1,884,151	2,143,877
Provision for bad debts	5,216,314	5,281,822
Administrative, personnel and other adjustments	<u>378,380</u>	<u>407,333</u>
	<u>40,743,103</u>	<u>43,245,105</u>
Net patient service revenue	\$ <u>32,748,045</u>	\$ <u>32,873,244</u>

8. Charity Care

The amounts of indirect and direct costs incurred by the Hospital for services and supplies furnished under the Hospital's charity care policy were approximately \$696,000 and \$792,000 (*unaudited*) for the years ended December 31, 2013 and 2012, respectively. These costs were estimated by management using a ratio of cost to gross charges.

9. Retirement Plan

The Hospital has a defined contribution pension plan covering substantially all employees of the Hospital. Under the terms of the plan, covered employees may contribute a percentage of their bi-weekly gross pay, with matching contributions by the Hospital up to 3%. For the years ended December 31, 2013 and 2012, the amount of retirement expense was \$211,223 and \$203,928 (*unaudited*), respectively.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

10. Concentration of Credit Risk

Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers are as follows as of December 31:

	<u>2013</u>	(Unaudited) <u>2012</u>
Medicare	32 %	53 %
Medicaid	10	17
Commercial	17	6
All other	<u>41</u>	<u>24</u>
	<u>100 %</u>	<u>100 %</u>

Management believes the credit risks associated with the receivables from governmental programs are minimal. Non-government receivables are from various payers that are subject to differing economic conditions. Such non-government receivables do not represent any concentration risks to the Hospital. Management continually monitors and adjusts the allowance for uncollectible accounts associated with the credit risk of patient accounts receivable.

11. Provider Tax

The Indiana General Assembly enacted legislation which established a Hospital Assessment Fee for the purpose of funding the Medicaid program and providing the state share of the disproportionate share hospital (DSH) payments. The Hospital Assessment Fee and increases in funding levels are to continue through June 30, 2015 based on recently passed legislation. The calculation of the assessment fee is based on the hospital's cost report information. Due to the Hospital Assessment Fee, inpatient and outpatient Medicaid payment rates were increased by certain published adjustment factors, for both fee-for-service and managed care programs. DSH funds were paid to the Hospital based on its respective hospital specific limit. For the years ended December 31, 2013 and 2012, provider taxes amounted to \$1,564,119 and \$1,564,371 (*unaudited*), respectively. For the years ended December 31, 2013 and 2012, DSH funds paid to the Hospital were \$416,652 and \$1,890,322 (*unaudited*), respectively.

12. Commitments

Management Contract

The Hospital has contracted with Alliant Management Services (Alliant) to operate, manage and supervise day-to-day activities of the Hospital. Under the terms of the contract, the management fee is approximately \$706,000 and adjusted annually by an agreed-upon inflationary adjustment. Total management and consulting fees paid to Alliant during the years ended December 31, 2013 and 2012 were \$690,646 and \$548,835 (*unaudited*), respectively.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

13. Risk Management and Contingent Liabilities

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; and employee health and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. The Hospital is insured for medical malpractice claims and judgments via healthcare professional and general liability insurance on a claims-made basis. Insurance coverages are \$1,000,000 individually and \$2,000,000 in the aggregate, annually, for both the Hospital's professional and general liability policies. In addition the Hospital has an excess healthcare professional liability policy and a healthcare umbrella liability policy that offer additional coverage. Management intends to maintain such coverages in the future and is of the opinion that insurance coverages are adequate to cover any potential losses on asserted claims.

14. Healthcare Reform

Patient Protection and Affordable Care Act

On March 23, 2010, *The Patient Protection and Affordable Care Act* (the Act) was signed into law. The effects of this legislation on hospitals are wide-ranging and potentially dramatic. In particular, the Act imposes additional requirements on hospital seeking to obtain or maintain charitable tax-exempt status as defined under Section 501 of the Code. Hospitals seeking to obtain or maintain charitable tax-exempt status must now:

- 1) *Conduct a community health needs assessment.* Hospitals must conduct a community health needs assessment once every three years and then adopt and implement a strategy addressing the needs associated with the assessment.
- 2) *Establish written financial assistance and emergency care policies.*
- 3) *Limit billed charge amounts for emergency or other medically necessary care to patients eligible for financial assistance.*
- 4) *Prohibit the use of "extraordinary" collection efforts on patients who qualify for financial assistance.*

Charitable hospitals seeking to obtain or maintain charitable tax-exempt status must meet the new requirements by fiscal years beginning after March 23, 2010 with the exception of the community health needs assessment which is required for fiscal years beginning after March 23, 2012.

The Hospital believes it is in compliance with the Act.

The Recovery Act

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (the Recovery Act) was signed into law. A major component of the Recovery Act is its emphasis on improving health information technology (also known as HIT). The federal government believes the implementation of technology will ultimately increase the quality and reduce the cost of healthcare.

PERRY COUNTY MEMORIAL HOSPITAL

Notes to the Combined Financial Statements, continued

14. Healthcare Reform, continued

The Recovery Act, continued

To accomplish the improvement in HIT, the Recovery Act includes payment incentives for qualifying professionals. Physicians and hospitals that are considered early adopters of electronic health records can become eligible to receive a significant amount of money from Medicare or Medicaid.

During the fiscal year ended December 31, 2012, the Hospital applied for and received approximately \$822,300 (*unaudited*) in Medicaid HIT funds, which is included in other revenue in the accompanying combined statements of operations and changes in net assets. During the fiscal year ended December 31, 2013, the Hospital did not receive any HIT funds. The Hospital intends to apply for additional funds in the coming years. The funds received and any funds from future applications are dependent upon reaching certain metrics and various states of "meaningful use" as defined by the Recovery Act.

PERRY COUNTY MEMORIAL HOSPITAL

Combining Balance Sheet

December 31, 2013

Assets	Perry County Memorial Hospital	Perry County Memorial Hospital Association	Perry County Memorial Hospital Foundation	Eliminations	Combined
Current assets:					
Cash and cash equivalents	\$ 3,758,389	\$ -	\$ 9,568	\$ -	\$ 3,767,957
Investments	8,852,692	-	1,941,206	-	10,793,898
Patient accounts receivable, net of estimated uncollectibles	6,050,390	-	-	-	6,050,390
Other accounts receivable	82,745	-	-	-	82,745
Inventories	766,958	-	-	-	766,958
Prepaid expenses and other current assets	<u>605,730</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>605,730</u>
Total current assets	20,116,904	-	1,950,774	-	22,067,678
Assets limited as to use:					
Internally designated for capital acquisition	2,457,232	-	-	-	2,457,232
Permanently restricted funds	155,000	-	-	-	155,000
Construction funds held by trustee	<u>3,750,763</u>	<u>2,862</u>	<u>-</u>	<u>-</u>	<u>3,753,625</u>
Total assets limited as to use	6,362,995	2,862	-	-	6,365,857
Property and equipment, net	9,754,287	14,919,287	-	-	24,673,574
Other assets	<u>24,999</u>	<u>-</u>	<u>51,577</u>	<u>-</u>	<u>76,576</u>
Total assets	<u>\$ 36,259,185</u>	<u>\$ 14,922,149</u>	<u>\$ 2,002,351</u>	<u>\$ -</u>	<u>\$ 53,183,685</u>

See Report of Independent Auditors.

PERRY COUNTY MEMORIAL HOSPITAL

Combining Balance Sheet, continued

December 31, 2013

Liabilities and Net Assets	Perry County Memorial Hospital	Perry County Memorial Hospital Association	Perry County Memorial Hospital Foundation	Eliminations	Combined
Current liabilities:					
Accounts payable	\$ 735,185	\$ -	\$ -	\$ -	\$ 735,185
Construction payables	-	4,277,464	-	-	4,277,464
Accrued payroll	1,567,772	-	-	-	1,567,772
Other accrued expenses	761,316	-	-	-	761,316
Estimated third-party payor settlements	2,030,000	-	-	-	2,030,000
Current portion of long-term debt	<u>144,801</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>144,801</u>
Total current liabilities	5,239,074	4,277,464	-	-	9,516,538
Long-term debt, net of current portion	<u>165,206</u>	<u>9,140,340</u>	<u>-</u>	<u>-</u>	<u>9,305,546</u>
Total liabilities	5,404,280	13,417,804	-	-	18,822,084
Net assets:					
Unrestricted	30,699,905	1,504,345	2,002,351	-	34,206,601
Permanently restricted	<u>155,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>155,000</u>
Total net assets	<u>30,854,905</u>	<u>1,504,345</u>	<u>2,002,351</u>	<u>-</u>	<u>34,361,601</u>
Total liabilities and net assets	<u>\$ 36,259,185</u>	<u>\$ 14,922,149</u>	<u>\$ 2,002,351</u>	<u>\$ -</u>	<u>\$ 53,183,685</u>

See Report of Independent Auditors.

PERRY COUNTY MEMORIAL HOSPITAL

Combining Statement of Operations and Changes in Net Assets

Year ended December 31, 2013

	Perry County Memorial Hospital	Perry County Memorial Hospital Association	Perry County Memorial Hospital Foundation	Eliminations	Combined
Revenues, gains, and other support:					
Net patient service revenue (net of contractual discounts and allowances)	\$ 37,964,359	\$ -	\$ -	\$ -	\$ 37,964,359
Provision for bad debts	(5,216,314)	-	-	-	(5,216,314)
Net patient service revenue less provision for bad debts	32,748,045	-	-	-	32,748,045
Investment income	624,291	-	79,031	-	703,322
Other revenue	326,044	-	70,368	-	396,412
Total revenues, gains, and other support	33,698,380	-	149,399	-	33,847,779
Expenses:					
Salaries and other wage costs	17,281,413	-	-	-	17,281,413
Supplies and other expenses	3,329,243	-	-	-	3,329,243
General and administrative expenses	1,775,707	-	-	-	1,775,707
Professional fees	2,323,200	-	-	-	2,323,200
Contracted services	5,986,372	-	-	-	5,986,372
Depreciation and amortization	1,088,609	-	-	-	1,088,609
Provider tax expense	1,564,119	-	-	-	1,564,119
Other direct expenses	1,054,481	-	24,550	-	1,079,031
Interest expense	20,787	-	-	-	20,787
Total expenses	34,423,931	-	24,550	-	34,448,481
(Deficit) excess of revenues over expenses	(725,551)	-	124,849	-	(600,702)
Change in net unrealized gains and losses on investments	-	-	240,447	-	240,447
(Decrease) increase in net assets	(725,551)	-	365,296	-	(360,255)
Net assets, beginning of year	31,580,456	1,504,345	1,637,055	-	34,721,856
Net assets, end of year	\$ 30,854,905	\$ 1,504,345	\$ 2,002,351	\$ -	\$ 34,361,601

See Report of Independent Auditors.

Perry County Memorial Hospital

Schedule of Expenditures of Federal Awards

Year ended December 31, 2013

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Grant / Contract Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
U.S. Department of Agriculture: Community Facilities Loans and Grants		10.766	\$ <u>14,919,287</u>
Total expenditures of federal awards			\$ <u>14,919,287</u>

Perry County Memorial Hospital

Notes to the Schedule of Expenditures of Federal Awards

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Perry County Memorial Hospital (the Hospital) and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. Health and Human Services Grant

Perry County Memorial Hospital did not provide a federal award to a subrecipient during the year ended December 31, 2013.

**Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

Report of Independent Auditors

Board of Trustees
Perry County Memorial Hospital
Tell City, Indiana

We have audited, in accordance with the 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 combined financial statements of Perry County Memorial Hospital (the Hospital), which comprise the combined balance sheet as of December 31, 2013, and the related combined statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the combined financial statements, and have issued our report thereon dated September 8, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the combined financial statements, we considered the Hospital's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the combined 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.

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 entity's combined financial statements will not be prevented, or detected and corrected on a timely basis. 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, material weaknesses may exist that have not been identified. We identified certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control, items 2014-001, 2014-002, and 2014-003.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's combined financial statements are free from 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*.

Hospital's Response to Findings

The Hospital's responses to the findings identified in our audit are described in the accompanying *Schedule of Findings and Questioned Costs*. Those responses were not subjected to the auditing procedures applied in the audit of the combined financial statements and, accordingly, we express no opinion on them.

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 Hospital'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.

Dean Dotson Allen Ford, PLLC

September 8, 2014
Louisville, Kentucky

**Report on Compliance for Each Major Program and Report on Internal Control Over Compliance
Required by OMB Circular A-133**

Report of Independent Auditors

Board of Trustees
Perry County Memorial Hospital
Tell City, Indiana

Report on Compliance for Each Major Federal Program

We have audited the compliance of Perry County Memorial Hospital (the Hospital) with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the Hospital's major federal program for the year ended December 31, 2013. The Hospital's major federal program is identified in the summary of auditors' results section of the accompanying *Schedule of Findings and Questioned Costs*.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Hospital's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Hospital's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Hospital's compliance.

Opinion on Each Major Federal Program

In our opinion, the Hospital complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2013.

Report on Internal Control Over Compliance

Management of the Hospital is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Hospital's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Dean Dotson Allen Ford, PLLC

September 8, 2014
Louisville, Kentucky

Perry County Memorial Hospital

Schedule of Findings and Questioned Costs

Year ended December 31, 2013

Section I - Summary of Auditors' Results (under Section .505(d)(1) of OMB Circular A-133):

Financial Statements:

- a. The type of report issued on the financial statements: **Unmodified opinion**
- b. Internal control over financial reporting:
 - Material weaknesses: **No**
 - Significant deficiencies that are not considered to be material weaknesses: **Yes**
- c. Noncompliance which is material to the financial statements: **No**

Federal Award:

- d. Internal control over major programs:
 - Material weaknesses: **No**
 - Significant deficiencies that are not considered to be material weaknesses: **None noted**
- e. The type of report issued on compliance for major programs: **Unmodified opinion**
- f. Any audit findings which are required to be reported under Section .510(a) of OMB Circular A-133: **None noted**
- g. Major programs:
 - USDA Loan Program, CFDA 10.766**
- h. Dollar threshold used to distinguish between Type A and Type B programs: **\$300,000**
- i. Auditee qualified as a low-risk auditee: **No**

Perry County Memorial Hospital

Schedule of Findings and Questioned Costs, continued

Year ended December 31, 2013

Section II - Financial Statement Findings (under Section .505(d)(2) of OMB Circular A-133):

Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*: 2013-001, 2013-002, 2013-003

Finding 2013-001:

Condition, Effect, and Recommendation:

Payroll Segregation of Duties

Our review of the payroll process revealed an inadequate segregation of duties among the payroll department personnel. Specifically, it was noted that the personnel responsible for processing the periodic payroll also have access to perform maintenance of personnel information, including but not limited to individual pay rates. It should also be noted that a periodic review of the processed payroll and personnel information is not performed by senior management.

We recommend that access controls within the payroll system and module be evaluated to ensure that there is a proper segregation of duties between the personnel responsible for processing the payroll and those personnel responsible for maintaining individual employee records. In addition, we recommend that senior management perform periodic review of the processed payroll as well as perform reviews of the pay information for Hospital personnel to ensure that the approved employee payroll information remains accurate.

Management Response:

Although all 3 employees in the HR/Payroll Department have access to all controls in the payroll system, we actually do segregate duties during the payroll processing.

- Initial input of individual employee information – Jessica
- Time Sheets, Time Clock Adjustments, Time Off Requests – Lacy
- Verifying pay increases, calculating refunds, entering payroll deductions, garnishments – Sheila
- Entering the pay increases in the system - Jessica

Senior Management is provided with various payroll reports following each payroll processing for their review.

H.R. provides the CEO and The Board of Trustees a payroll report for each pay period that is examined and certified.

Perry County Memorial Hospital

Schedule of Findings and Questioned Costs, continued

Year ended December 31, 2013

Finding 2013-002:

Condition, Effect, and Recommendation:

Cash Account Reconciliations

Our review of the cash account reconciliations revealed that reconciling items are not being resolved in a timely manner to ensure that the Hospital's cash account balances are accurately reflected in the financial statements and that the funds remain intact.

We recommend that the both the preparer and the reviewer of the monthly cash account reconciliations evaluate any reconciling items noted and take necessary actions to ensure that they are investigated and resolved in a timely manner.

Management Response:

Management will review cash account reconciliations and work to get reconciling items resolved timely.

Finding 2013-003:

Condition, Effect, and Recommendation:

Contractual and Bad Debt Allowances

Our review of the Hospital's contractual and bad debt allowances revealed that a documented policy was not available, resulting in the risk that the periodic adjustments to these accounts are not consistently applied or accurately capture in the Hospital's net realizable value for patient accounts receivable.

We recommend that senior management develop a formal policy for evaluating patient contractual and bad debt allowances. At a minimum, the policy should include an adequate look-back period by major payers and/or by department to ensure that the Hospital's historical reimbursement trends are captured. This will allow for an adequate review process by senior management so that adjustments to these allowances are accurately recorded to properly state patient accounts receivable to their net realizable value.

The review of the contractual and bad debt allowances should be incorporated into the Hospital's financial close and reporting process to ensure that these settlements are accurately captured in the Hospital's financial statements.

The policy itself should also be evaluated periodically by senior management and the Board of Trustees to account for and adjusted accordingly for changes in the Hospital's payer mix, governmental and commercial reimbursement terms, and commercial insurance contracts.

Perry County Memorial Hospital

Schedule of Findings and Questioned Costs, continued

Year ended December 31, 2013

Finding 2013-003, continued:

Management Response:

Management will develop a policy related to the Contractual and Bad Debt calculations which are included in the monthly financial statements.

Section III - Federal Award Findings and Questioned Costs (under Section .505(d)(3) of OMB Circular A-133):

Findings and Questioned Costs relating to Federal Awards: **None noted**