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February 5, 2016

Board of Directors
Sullivan County Community Hospital
2200 North Section Street
Sullivan, IN 47882

We have reviewed the audit report prepared by BKD, LLP, Independent Public Accountants, for the period January 1, 2014 to December 31, 2014. 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 Sullivan County Community Hospital, as of December 31, 2014 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.

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

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

Auditor's Report and Financial Statements
December 31, 2014 and 2013

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
December 31, 2014 and 2013

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Independent Auditor's Report

Board of Trustees
Sullivan County Community Hospital
Sullivan, Indiana

We have audited the accompanying financial statements of Sullivan County Community Hospital (Hospital), and its discretely presented component unit, collectively, a component unit of Sullivan County, Indiana, which are comprised of the balance sheets as of December 31, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 respective financial position of Sullivan County Community Hospital and its discretely presented component unit as of December 31, 2014 and 2013, and the respective changes in financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis 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 audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The report to the board of trustees summarizing the 2014 audit results is presented for the purposes of additional analysis and is not a required part of the basic 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
June 10, 2015

Sullivan County Community Hospital

A Component Unit of Sullivan County, Indiana

Management's Discussion and Analysis

Year Ended December 31, 2014 and 2013

Introduction

This management's discussion and analysis of the financial performance of Sullivan County Community Hospital (Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2014 and 2013. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and investments decreased in 2014 by \$1,407,820 or 8.3% compared to an increase of \$1,501,545 or 8.9% in 2013.
- The Hospital's net position increased in 2014 by \$1,316,992 or 4.3% compared to an increase of \$515,275 or 1.7% in 2013.
- The Hospital reported operating income in both 2014 (\$1,256,842) and 2013 (\$525,235). The operating income in 2014 increased by \$731,607 or 139.3%, while in 2013, the operating income decreased by \$1,286,161 or 71%.
- Net nonoperating revenues for 2014 were \$60,150 compared to net nonoperating expenses of \$9,960 for 2013. This is an increase of \$70,110 or 703.9%. In 2013, net nonoperating expenses decreased by \$130,081 or 108%.

Using This Annual Report

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

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

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

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

The Statements of Cash Flows

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

The Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the balance sheets. The Hospital's net position increased by \$1,316,992 or 4.3% in 2014 over 2013 compared to an increase in net position of \$515,275 or 1.7% in 2013 over 2012 as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2014	2013	2012
Assets			
Patient accounts receivable, net	\$ 3,960,234	\$ 3,139,867	\$ 2,548,719
Other current assets	2,737,590	2,819,154	4,326,957
Capital assets, net	13,925,257	13,433,353	13,970,852
Other noncurrent assets	14,012,907	14,947,022	12,323,879
	<u>\$ 34,635,988</u>	<u>\$ 34,339,396</u>	<u>\$ 33,170,407</u>
Liabilities			
Other current liabilities	\$ 2,774,835	\$ 3,795,235	\$ 3,141,521
Net Position			
Net investment in capital assets	13,925,257	13,433,353	13,970,852
Unrestricted	17,935,896	17,110,808	16,058,034
Total net position	<u>31,861,153</u>	<u>30,544,161</u>	<u>30,028,886</u>
	<u>\$ 34,635,988</u>	<u>\$ 34,339,396</u>	<u>\$ 33,170,407</u>
Total liabilities and net position	<u>\$ 34,635,988</u>	<u>\$ 34,339,396</u>	<u>\$ 33,170,407</u>

A significant change in the Hospital's assets in 2014 is the increase in patient accounts receivable of approximately \$820,000 or 26%. This increase was a result of an increase in net patient service revenue of approximately \$4,105,000 or 16% from \$25,767,488 in 2013 to \$29,872,951 in 2014 as well an increase in physician operations with the addition of one new clinic in 2014. This increase in patient accounts receivable represents approximately 4 days of revenue as the collection cycle has been extended due to credentialing delays with the transition of all physician clinics to a separate legal entity, MSO Clinics, Inc. (Clinics), which is a blended component unit of the Hospital.

Patient accounts receivable increased in 2013 by approximately \$600,000 or 23%. Although net patient service revenues decreased during the year by \$399,178 or 1.5% from \$26,166,666 in 2012 to \$25,767,488 in 2013, net patient accounts receivable increased by \$591,148 or 23% from \$2,548,719 in 2012 to \$3,139,867 in 2013 or approximately 8 days of revenue at December 31, 2013, versus December 31, 2012. This increase in receivables was a combination of a decrease in the Hospital's accounts receivable of approximately \$200,000 for inpatient and outpatient charges, and an increase in Hospital physician receivables of approximately \$800,000 as a result of acquiring a significant family practice in the last quarter of 2013.

Another significant change in the Hospital's financial position in 2014 was a decrease in cash and investments of approximately \$1,408,000. This decrease was largely driven by an increase in purchases of capital assets with the opening of one new clinic in 2014. In 2013, there was a decrease in cash of approximately \$1,122,000 and an increase in investments of approximately \$2,623,000 as a rebalancing of the Hospital's cash and investment portfolio occurred.

Operating Results and Changes in the Hospital's Net Position

In 2014, the Hospital's net position increased by \$1,316,992 or 4.3%, as shown in Table 2. This increase is made up of several different components and represents an increase of 156% compared with the increase in net position for 2013 of \$515,275. In 2013, the increase in net position of \$515,275 represents a decrease of 73.3% compared with the increase in net position for 2012 of \$1,931,517.

Table 2: Operating Results and Changes in Net Position

	2014	2013	2012
Operating Revenues			
Net patient service revenue	\$ 29,872,951	\$ 25,767,488	\$ 26,166,666
Other operating revenues	379,175	438,970	122,445
Total operating revenues	<u>30,252,126</u>	<u>26,206,458</u>	<u>26,289,111</u>
Operating Expenses			
Salaries and wages and employee benefits	16,464,400	14,161,416	13,186,938
Purchased services and professional fees	3,512,337	3,738,438	3,226,248
Depreciation and amortization	1,756,510	1,732,403	1,725,234
Other operating expenses	7,262,037	6,048,966	6,339,295
Total operating expenses	<u>28,995,284</u>	<u>25,681,223</u>	<u>24,477,715</u>
Operating Income	<u>1,256,842</u>	<u>525,235</u>	<u>1,811,396</u>
Nonoperating Revenues (Expenses)			
Investment income	46,297	(397)	130,727
Interest expense	-	-	(3,182)
Other	13,853	(9,563)	(7,424)
Total nonoperating revenues (expenses)	<u>60,150</u>	<u>(9,960)</u>	<u>120,121</u>
Increase in Net Position	<u>\$ 1,316,992</u>	<u>\$ 515,275</u>	<u>\$ 1,931,517</u>

Operating Income

The first component of the overall change in the Hospital's net position is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In each of the past three years, the Hospital has reported an operating income. This is consistent with the Hospital's recent operating history as the Hospital was formed and is operated primarily to serve residents of Sullivan County and the surrounding area. The Hospital implements strong cost controls to provide sufficient resources to enable the facility to serve lower income and other residents.

The operating income was \$1,256,842 for 2014 compared to \$525,235 for 2013, which equates to an increase of \$731,607 or 139.3%, while the operating income for 2013 decreased by \$1,286,161 or 71.0% as compared to 2012. The primary components of the increased operating income in 2014 are:

- Net patient service revenue was \$29,872,951 for 2014 compared to \$25,767,488 in 2013, which is an increase of \$4,105,463 or 15.9%.
- Salaries, wages and benefits for the Hospital's employees were \$16,464,400 for 2014 compared to \$14,161,416 for 2013, which results in an increase of \$2,302,984 or 16.3%.

One component of the increase in net patient service revenue in 2014 was an increase of approximately \$781,000 as a result of changes to Indiana supplemental payment mechanisms for the Medicaid program. The Hospital Assessment Fee (HAF) program, which began in 2012 and terminated June 30, 2013, was re-instated in March 2014 resulting in an increase in net patient service revenue of approximately \$1.5 million between 2014 and 2013. This increase was partially offset by a decrease in the Medicaid Disproportionate Share (DSH) revenue of approximately \$719,000. In 2013, changes in HAF reimbursement resulted in a decrease in net patient service revenue of approximately \$1.9 million between 2013 and 2012. This decrease was partially offset by an increase in DSH revenue of approximately \$1.1 million.

The funding of these supplemental payment programs are made partially through an assessed tax on Indiana hospitals, which is recorded as an operating expense in the statements of revenues, expenses and changes in net position. The assessed tax in 2014 totaled \$1,715,452, an increase of \$941,661 from the assessed tax of \$773,791 in 2013. The tax in 2013 was a decrease of \$568,485 from the assessed tax of \$1,342,276 in 2012.

Employee salaries and wages and benefits increased in both 2014 and 2013 in connection with the Hospital's retention and recruitment efforts. These efforts result primarily from the shortage of nurses and other health care professionals in the United States. Additionally in 2014, the Hospital opened a new clinic resulting in increased employee salary and wages and benefits.

The rate of health care inflation has a direct effect on the cost of services provided by the Hospital. Expenditures for supplies and prescription drugs are a major component of the Hospital's costs. In 2014, supplies and prescription drug costs totaled \$2,726,500, or 9.4%, of total operating expenses. In 2013, they totaled \$2,456,455, or 9.6%, of total operating expenses.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income, rental income on Hospital-owned property and payments made to subsidize the Hospital's discretely presented component unit. Rental income increased approximately \$45,000 in 2014 as compared to 2013 from rentals of portions of the newly constructed clinic. Investment income increased by \$46,694 in 2014 compared to 2013, as a result of market conditions, while investment income decreased by \$131,124 between 2013 and 2012.

The Hospital's Cash Flows

The Hospital's operating cash flows decreased approximately \$1,975,000 in 2014 compared to 2013. The primary driver of this decrease was an increase in patient accounts receivable for the Clinics as well as a decrease in amounts due to third-party payers. The Hospital's cash flows from investing activities increased by \$3,627,000 in 2014 compared to 2013 as a result of the disposition of certain investments used to fund capital purchases.

Capital Asset and Debt Administration

Capital Assets

At the end of 2014, the Hospital had \$13,925,257 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. In 2014 and 2013, the Hospital had capital acquisitions of approximately \$2,200,000 and \$1,200,000, respectively. The majority of these purchases were related to construction of buildings and leasehold improvements at clinic sites as well as replacement equipment.

Debt

The Hospital issued no new debt in 2014 or 2013, and has no outstanding debt as of December 31, 2014 or 2013.

Contacting the Hospital's Financial Management

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

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Balance Sheets
December 31, 2014 and 2013

Assets

	2014	2013
Current Assets		
Cash	\$ 1,505,893	\$ 1,979,598
Patient accounts receivable, net of allowance: 2014 - \$2,554,200, 2013 - \$1,865,800	3,960,234	3,139,867
Supplies	606,837	552,437
Estimated amounts due from third-party payers	185,930	-
Prepaid expenses and other current assets	438,930	287,119
Total current assets	6,697,824	5,959,021
 Noncurrent Cash and Investments - Funded depreciation	 14,012,907	 14,947,022
 Capital Assets	 13,925,257	 13,433,353
Total assets	\$ 34,635,988	\$ 34,339,396

Liabilities and Net Position

Current Liabilities		
Accounts payable	\$ 767,225	\$ 860,449
Accrued expenses	2,007,610	1,957,915
Estimated amounts due to third-party payers	-	976,871
Total current liabilities	2,774,835	3,795,235
 Net Position		
Net investment in capital assets	13,925,257	13,433,353
Unrestricted	17,935,896	17,110,808
Total net position	31,861,153	30,544,161
Total liabilities and net position	\$ 34,635,988	\$ 34,339,396

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
SCCH Fitness Center, Inc.
Statements of Financial Position
December 31, 2014 and 2013

Assets

	2014	2013
Property and equipment, net of accumulated depreciation of \$726,414 and \$670,111 for 2014 and 2013, respectively	\$ 518,607	\$ 574,911
Total assets	\$ 518,607	\$ 574,911

Liabilities and Net Assets

Liabilities		
Accrued expenses	\$ 19,950	\$ 21,972
Net Assets - Unrestricted	498,657	552,939
Total liabilities and net assets	\$ 518,607	\$ 574,911

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2014 and 2013

	2014	2013
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts of \$5,075,241 and \$4,891,219 for 2014 and 2013, respectively	\$ 29,872,951	\$ 25,767,488
Other	379,175	438,970
Total operating revenues	30,252,126	26,206,458
Operating Expenses		
Salaries and wages	13,124,173	11,070,849
Employee benefits	3,340,227	3,090,567
Purchased services and professional fees	3,512,337	3,738,438
Supplies	2,726,500	2,456,455
Utilities	451,331	425,387
Repair and maintenance	1,166,765	1,113,503
Leases and rentals	325,697	280,848
Insurance	364,313	332,283
Depreciation and amortization	1,756,510	1,732,403
Other	511,979	666,699
Provider hospital assessment fee	1,715,452	773,791
Total operating expenses	28,995,284	25,681,223
Operating Income	1,256,842	525,235
Nonoperating Revenues (Expenses)		
Investment income (loss)	46,297	(397)
Other	13,853	(9,563)
Total nonoperating revenues (expenses)	60,150	(9,960)
Increase in Net Position	1,316,992	515,275
Net Position, Beginning of Year	30,544,161	30,028,886
Net Position, End of Year	\$ 31,861,153	\$ 30,544,161

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
SCCH Fitness Center, Inc.
Statements of Activities
Years Ended December 31, 2014 and 2013

	2014	2013
Revenues, Gains and Other Support		
Membership, training, class and other revenue	\$ 211,890	\$ 207,224
Operating support from the Hospital	127,397	106,431
Total revenues, gains and other support	339,287	313,655
Expenses		
Salaries and wages	181,847	162,142
Employee benefits	88,632	84,091
Purchased services	26,513	23,690
Supplies	5,030	4,346
Utilities	19,539	18,604
Repair and maintenance	8,546	9,975
Depreciation	56,303	56,257
Other	7,159	6,906
Total expenses	393,569	366,011
Decrease in Net Assets	(54,282)	(52,356)
Unrestricted Net Assets, Beginning of Year	552,939	605,295
Unrestricted Net Assets, End of Year	\$ 498,657	\$ 552,939

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Statements of Cash Flows
Years Ended December 31, 2014 and 2013

	2014	2013
Operating Activities		
Receipts from and on behalf of patients	\$ 27,429,783	\$ 25,244,137
Payments to suppliers and contractors	(8,386,378)	(7,731,755)
Payments to employees	(16,414,705)	(13,804,453)
Other payments, net	(1,850,677)	(954,645)
Net cash provided by operating activities	778,023	2,753,284
Capital and Related Financing Activity - purchase of capital assets	(2,245,993)	(1,241,779)
Investing Activities		
Interest and dividends on investments	56,191	81,223
Purchase of investments	(8,540,144)	(5,190,267)
Proceeds from disposition of investments	9,464,365	2,485,504
Other investing activities	13,853	(9,563)
Net cash provided by (used in) investing activities	994,265	(2,633,103)
Decrease in Cash	(473,705)	(1,121,598)
Cash, Beginning of Year	1,979,598	3,101,196
Cash, End of Year	\$ 1,505,893	\$ 1,979,598
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 1,256,842	\$ 525,235
Depreciation	1,756,510	1,732,403
Loss on sale of capital assets	-	46,875
Provision for uncollectible accounts	5,075,241	4,891,219
Changes in operating assets and liabilities:		
Patient accounts receivable	(5,895,608)	(5,482,367)
Estimated amounts due to/from third-party payers	(1,162,801)	67,797
Accounts payable and accrued expenses	(43,529)	585,917
Other assets	(208,632)	386,205
Net cash provided by operating activities	\$ 778,023	\$ 2,753,284

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

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

Nature of Operations and Reporting Entity

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

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

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. Investment income is included in nonoperating revenues and expenses.

Use of Estimates

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

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Risk Management

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

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

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices.

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

Patient Accounts Receivable

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

Supplies

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

Capital Assets

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

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

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Compensated Absences

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

Net Position

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

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were \$249,515 for 2014 compared to \$116,835 for 2013.

SCCH Fitness Center

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

During the years ended December 31, 2014 and 2013, the Hospital provided \$127,397 and \$106,431, respectively, of support to the Fitness Center for operations.

Sullivan County Community Hospital
A Component Unit of Sullivan County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Income Taxes

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

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

MSO Clinics has applied for exempt status under Section 501(c)(3) of the U.S. Internal Revenue Code and a similar provision of state law. As of the date of the auditor's report, IRS approval has not been received.

Electronic Health Records Incentive Program

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

The Hospital began recognizing incentive payment revenue earned under the Medicare program in 2014, which was the period during which management was reasonably assured meaningful use was achieved and the earnings process was complete. The Hospital recorded revenue of approximately \$460,000 from Medicare in 2014, which is included in net patient service revenue in the statements of revenues, expenses and changes in net position. The Hospital has recognized Medicaid EHR funding in the amount of \$215,200 and \$309,000 in 2014 and 2013, respectively, which is included in other operating revenue in the statements of revenues, expenses and changes in net position.

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Reclassifications

Certain reclassifications have been made to the 2013 financial statements to conform to the 2014 financial statement presentation. These reclassifications had no effect on the change in net assets.

Note 2: Net Patient Service Revenue

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

Medicare. The Hospital is designated by Medicare as a critical access hospital (CAH).

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

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

Approximately 60% and 56% percent of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2014 and 2013, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital received approximately \$2.5 million and \$1.0 million during 2014 and 2013, respectively, 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 statements of revenues, expenses and changes in net position for 2014 and 2013. The Hospital paid approximately \$1,700,000 and \$800,000 into this Medicaid program for 2014 and 2013, which is recorded as an operating expense in the statements of revenues, expenses and changes in net position. The program is scheduled to sunset on June 30, 2017. There is no assurance this program will continue to be implemented in the future.

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The Hospital also qualifies as a Medicaid Disproportionate Share Hospital (DSH) provider under Indiana law and, as such, is eligible to receive supplemental Medicaid payments. The amounts of these supplemental payments are dependent on regulatory approval by agencies of the federal and state governments and is determined by level, extent and cost of uncompensated care and various other factors. Supplemental payments have been made by the State of Indiana, and the Hospital records such amounts as revenue when it has been reasonably determined that the funds will be received. The Hospital recognized \$595,773 and \$1,314,830 within net patient service revenue related to this supplemental payment program for the years ended December 31, 2014 and 2013, respectively.

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

Note 3: Deposits, Investments and Investment Income

Deposits

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

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal 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, in bank repurchase agreements, and other investments defined in Indiana Code 16-22-3-20.

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

December 31, 2014					
Maturities in Years					
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
Fixed income mutual funds	\$ 3,012,728	\$ 3,012,728	\$ -	\$ -	\$ -
	<u> </u>				

December 31, 2013					
Maturities in Years					
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
Fixed income mutual funds	\$ 2,997,959	\$ 2,997,959	\$ -	\$ -	\$ -
	<u> </u>				

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

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in certain bond and mutual funds to the American Hospital Association's Investment Fund and other portfolios with AAA or government-backed ratings. At December 31, 2014 and 2013, the Hospital's investments in bond funds were rated by Standard & Poor's and or Moody's Investors Service as follows:

December 31, 2014					
Type	Fair Value	AAA	AA	A	BBB
Fixed income mutual funds	\$ 3,012,728	\$ 1,074,640	\$ 586,578	\$ 1,210,815	\$ 140,695
	<u> </u>				

December 31, 2013					
Type	Fair Value	AAA	AA	A	BBB
Fixed income mutual funds	\$ 2,997,959	\$ 1,234,859	\$ 542,331	\$ 1,132,329	\$ 88,440
	<u> </u>				

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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 sheets as follows:

	2014	2013
Carrying value:		
Deposits	\$ 12,506,072	\$ 13,928,661
Investments	3,012,728	2,997,959
	\$ 15,518,800	\$ 16,926,620
Included in the following balance sheets captions:		
Cash	\$ 1,505,893	\$ 1,979,598
Noncurrent cash and investments - funded depreciation	14,012,907	14,947,022
	\$ 15,518,800	\$ 16,926,620

Investment Income

Investment income for the years ended December 31 consisted of:

	2014	2013
Interest and dividend income	\$ 56,191	\$ 81,223
Net decrease in fair value of investments	(9,894)	(81,620)
Investment income (loss)	\$ 46,297	\$ (397)

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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:

	2014	2013
Medicare	\$ 976,847	\$ 748,500
Medicaid	239,252	561,181
Other third-party payers	2,560,721	1,696,350
Patients	2,737,614	1,999,636
	6,514,434	5,005,667
Less allowance for uncollectible accounts	2,554,200	1,865,800
	\$ 3,960,234	\$ 3,139,867

Note 5: Capital Assets

Capital assets activity for the years ended December 31 was:

	2014				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Hospital					
Land	\$ 1,042,227	\$ -	\$ -	\$ -	\$ 1,042,227
Buildings and leasehold improvements	16,948,085	1,862,627	-	235,466	19,046,178
Equipment	15,175,648	383,366	(19,264)	-	15,539,750
Construction in progress	235,466	-	-	(235,466)	-
	33,401,426	2,245,993	(19,264)	-	35,628,155
Less accumulated depreciation:					
Buildings and leasehold improvements	10,008,236	759,413	-	-	10,767,649
Equipment	9,959,837	997,097	(21,685)	-	10,935,249
	19,968,073	1,756,510	(21,685)	-	21,702,898
Total Hospital capital assets, net	\$ 13,433,353	\$ 489,483	\$ 2,421	\$ -	\$ 13,925,257

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	2013				Ending Balance
	Beginning Balance	Additions	Disposals	Transfers	
Hospital					
Land	\$ 1,042,227	\$ -	\$ -	\$ -	\$ 1,042,227
Buildings and leasehold improvements	16,890,207	57,878	-	-	16,948,085
Equipment	14,456,582	948,435	(264,710)	35,341	15,175,648
Construction in progress	35,341	235,466	-	(35,341)	235,466
	<u>32,424,357</u>	<u>1,241,779</u>	<u>(264,710)</u>	<u>-</u>	<u>33,401,426</u>
Less accumulated depreciation:					
Buildings and leasehold improvements	9,480,816	745,255	(217,835)	-	10,008,236
Equipment	8,972,689	987,148	-	-	9,959,837
	<u>18,453,505</u>	<u>1,732,403</u>	<u>(217,835)</u>	<u>-</u>	<u>19,968,073</u>
Total Hospital capital assets, net	<u>\$ 13,970,852</u>	<u>\$ (490,624)</u>	<u>\$ (46,875)</u>	<u>\$ -</u>	<u>\$ 13,433,353</u>

Note 6: Medical Malpractice Claims

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

Note 7: Employee Health Claims

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

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Activity in the Hospital's accrued employee health claims liability during 2014 and 2013 is summarized as follows:

	2014	2013
Balance, beginning of year	\$ 182,123	\$ 141,190
Current year claims incurred and changes in estimates for claims incurred in prior years	1,532,808	1,801,423
Claims and expenses paid	(1,482,708)	(1,760,490)
Balance, end of year	\$ 232,223	\$ 182,123

Note 8: Pension Plan

The Hospital & MSO Clinic contribute to defined-contribution pension plans covering substantially all employees following one year of service. Pension expense is recorded for the amount of the employer's required contributions, determined in accordance with the terms of the plans. The Hospital plans are administered by a board of trustees appointed by the Hospital Board. The MSO Clinic plan is administered by its governing body. The plans provide retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan documents and were established and can be amended by action of the Hospital's governing body. Plan members may contribute up to \$17,500 of their annual covered salary. The Hospital and MSO Clinic are required to match one-half of the employee contribution up to 5% of employee's compensation. In addition, the Hospital contributes 2% of the annual covered payroll for all eligible active participants. The MSO Clinics may make a discretionary contribution as determined by its governing body. Expense related to employer contributions to the plans was \$250,741 for 2014 and \$256,092 for 2013. The Hospital had accrued benefits payable to the plan of \$166,945 at December 31, 2014 compared to \$166,870 as of December 31, 2013.

Note 9: Operating Leases

A noncancellable operating lease for primary care outpatient office space began in October 2013 and expires in October 2018. This lease contains renewal options for five year periods and requires the Hospital to pay all executory costs (property taxes, maintenance and insurance). Rental expense for operating leases during 2014 and 2013 were \$206,452 and \$280,848, respectively. Future minimum lease payments at December 31, 2014 were:

2015	\$ 220,486
2016	220,486
2017	220,486
2018	165,365
	\$ 826,823

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Note 10: Contingencies

Litigation

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

Note 11: 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 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. In 2015, the state of Indiana expanded its Medicaid program with the implementation of the Healthy Indiana Plan (HIP) 2.0. Under HIP 2.0, the first \$2,500 of beneficiary medical expenses are reimbursed from special savings accounts funded partly by the state and partly by the beneficiary. The impact of Medicaid expansion under the HIP 2.0 program on the Hospital's revenues is currently unknown.

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Note 12: Combining Financial Statement Information and Blended Component Unit

The Hospital's combining financial statement information, including that of its blended component unit was summarized as follows for the year ended December 31, 2014:

Combining Balance Sheet as of December 31, 2014

	2014		
	Hospital	MSO Clinics	Total
Assets			
Current Assets			
Cash	\$ 1,461,979	\$ 43,914	\$ 1,505,893
Patient accounts receivable, net of allowance of \$2,554,200	3,027,023	933,211	3,960,234
Supplies	536,263	70,574	606,837
Estimated amounts due from third-party payers	185,930	-	185,930
Prepaid expenses and other current assets	438,930	-	438,930
Total current assets	5,650,125	1,047,699	6,697,824
Noncurrent Cash and Investments - Funded depreciation	14,012,907	-	14,012,907
Capital Assets	12,575,396	1,349,861	13,925,257
Total assets	\$ 32,238,428	\$ 2,397,560	\$ 34,635,988
Liabilities and Net Position			
Current Liabilities			
Accounts payable	\$ 767,225	\$ -	\$ 767,225
Accrued expenses	1,955,379	52,231	2,007,610
Total current liabilities	2,722,604	52,231	2,774,835
Net Position			
Net investment in capital assets	12,575,396	1,349,861	13,925,257
Unrestricted	16,940,428	995,468	17,935,896
Total net position	29,515,824	2,345,329	31,861,153
Total liabilities and net position	\$ 32,238,428	\$ 2,397,560	\$ 34,635,988

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Combining Statement of Revenues, Expenses and Changes in Net Position for the Year Ended December 31, 2014

	2014		
	Hospital	MSO Clinics	Total
Operating Revenues			
Net patient service revenue, net of provision for uncollectible accounts of \$5,075,241	\$ 28,055,545	\$ 1,817,406	\$ 29,872,951
Other	379,175	-	379,175
Total operating revenues	<u>28,434,720</u>	<u>1,817,406</u>	<u>30,252,126</u>
Operating Expenses			
Salaries and wages	11,291,315	1,832,858	13,124,173
Employee benefits	3,018,632	321,595	3,340,227
Purchased services and professional fees	3,414,581	97,756	3,512,337
Supplies	2,530,808	195,692	2,726,500
Utilities	439,675	11,656	451,331
Repair and maintenance	1,153,710	13,055	1,166,765
Leases and rentals	206,452	119,245	325,697
Insurance	338,532	25,781	364,313
Depreciation	1,713,805	42,705	1,756,510
Other	451,285	60,694	511,979
Provider hospital assessment fee	1,715,452	-	1,715,452
Total operating expenses	<u>26,274,247</u>	<u>2,721,037</u>	<u>28,995,284</u>
Operating Income (Loss)	<u>2,160,473</u>	<u>(903,631)</u>	<u>1,256,842</u>
Nonoperating Revenues			
Investment income	46,297	-	46,297
Other	13,853	-	13,853
Total nonoperating revenues	<u>60,150</u>	<u>-</u>	<u>60,150</u>
Increase (Decrease) in Net Position	2,220,623	(903,631)	1,316,992
Transfer From (To) Affiliate	(3,248,960)	3,248,960	-
Net Position, Beginning of Year	<u>30,544,161</u>	<u>-</u>	<u>30,544,161</u>
Net Position, End of Year	<u>\$ 29,515,824</u>	<u>\$ 2,345,329</u>	<u>\$ 31,861,153</u>

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Combining Statement of Cash Flows for the Year Ended December 31, 2014

	2014		
	Hospital	MSO Clinics	Total
Operating Activities			
Receipts from and on behalf of patients	\$ 26,545,588	\$ 884,195	\$ 27,429,783
Payments to suppliers and contractors	(7,852,619)	(533,759)	(8,386,378)
Payments to employees	(14,312,483)	(2,102,222)	(16,414,705)
Other receipts (payments), net	(1,789,983)	(60,694)	(1,850,677)
Net cash provided by (used in) operating activities	<u>2,590,503</u>	<u>(1,812,480)</u>	<u>778,023</u>
Noncapital Financing Activity - transfer from (to) affiliate	<u>(2,843,339)</u>	<u>2,843,339</u>	<u>-</u>
Capital and Related Financing Activity - Purchase of capital assets	<u>(1,259,048)</u>	<u>(986,945)</u>	<u>(2,245,993)</u>
Investing Activities			
Interest and dividends on investments	56,191	-	56,191
Purchase of investments	(8,540,144)	-	(8,540,144)
Proceeds from disposition of investments	9,464,365	-	9,464,365
Other investing activities	13,853	-	13,853
Net cash provided by investing activities	<u>994,265</u>	<u>-</u>	<u>994,265</u>
Increase (Decrease) in Cash	(517,619)	43,914	(473,705)
Cash, Beginning of Year	<u>1,979,598</u>	<u>-</u>	<u>1,979,598</u>
Cash, End of Year	<u>\$ 1,461,979</u>	<u>\$ 43,914</u>	<u>\$ 1,505,893</u>
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by (Used in) Operating Activities			
Operating income (loss)	\$ 2,160,473	\$ (903,631)	\$ 1,256,842
Depreciation	1,713,805	42,705	1,756,510
Provision for uncollectible accounts	4,826,680	248,561	5,075,241
Changes in operating assets and liabilities:			
Patient accounts receivable	(4,713,836)	(1,181,772)	(5,895,608)
Estimated amounts due to third-party payers	(1,162,801)	-	(1,162,801)
Accounts payable and accrued expenses	(95,760)	52,231	(43,529)
Other assets and liabilities	(138,058)	(70,574)	(208,632)
Net cash provided by (used in) operating activities	<u>\$ 2,590,503</u>	<u>\$ (1,812,480)</u>	<u>\$ 778,023</u>