

Hamilton County Hospital District

Accountants' Report and Financial Statements

September 30, 2012 and 2011



Hamilton County Hospital District
September 30, 2012 and 2011

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Independent Accountants' Report on Financial Statements

Board of Directors
Hamilton County Hospital District
Hamilton, Texas

We have audited the accompanying balance sheets of Hamilton County Hospital District (the District), as of September 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the District's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hamilton County Hospital District as of September 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

BKD, LLP

March 5, 2013

Hamilton County Hospital District

Management's Discussion and Analysis

Years Ended September 30, 2012 and 2011

Introduction

This management's discussion and analysis of the financial performance of Hamilton County Hospital District (the District) provides an overview of the District's financial activities for the years ended September 30, 2012 and 2011. It should be read in conjunction with the accompanying financial statements of the District.

Financial Highlights

- Cash increased in 2012 by \$285,607, or 13%, and increased in 2011 by \$987,735, or 77%.
- The District's net assets increased in 2012 by \$1,936,323, or a 17% increase. The District's net assets decreased in 2011 by \$641,772, or a 5% decrease.
- The District reported an operating income in 2012 of \$877,960 and an operating loss in 2011 of \$1,517,933. In 2010 the District reported operating income of \$693,502.
- Net nonoperating revenues decreased by \$224,284, or 26%, in 2012 compared to 2011, and increased by \$775,596, or 841%, in 2011 compared to 2010.

Using This Annual Report

The District's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. These statements provide information about the activities of the District, including resources held by the District but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The District 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 Sheet and Statement of Revenues, Expenses and Changes in Net Assets

One of the most important questions asked about any hospital's finances is "Is the hospital as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues, expenses and changes in net assets report information about the District'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 District's net assets and changes in them. The District's total net assets—the difference between assets and liabilities—is one measure of the District's financial health or financial position. Over time, increases or decreases in the District's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the District'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 District.

The Statement of Cash Flows

The statement of cash flows reports 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 District's Net Assets

The District's net assets are the difference between its assets and liabilities reported in the balance sheets. The District's net assets increased by \$1,936,323, or 17%, in 2012 over 2011, and decreased by \$641,772, or 5%, in 2011 as compared to 2010, as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2012	2011	2010
Assets			
Patient accounts receivable, net	\$ 2,526,660	\$ 2,978,797	\$ 5,214,130
Other current assets	7,365,735	6,189,803	3,010,853
Capital assets, net	14,431,205	15,371,937	14,749,162
Other noncurrent assets	255,501	409,353	2,628,741
	<u>\$ 24,579,101</u>	<u>\$ 24,949,890</u>	<u>\$ 25,602,886</u>
Liabilities			
Long-term debt	\$ 9,179,172	\$ 9,502,292	\$ 9,858,071
Other current and noncurrent liabilities	1,917,945	3,901,937	3,557,382
	<u>11,097,117</u>	<u>13,404,229</u>	<u>13,415,453</u>
Net Assets			
Invested in capital assets, net of related debt	5,033,418	3,763,560	4,297,338
Restricted-expendable by donors	104,634	1,335	-
Unrestricted	8,343,932	7,780,766	7,890,095
	<u>13,481,984</u>	<u>11,545,661</u>	<u>12,187,433</u>
	<u>\$ 24,579,101</u>	<u>\$ 24,949,890</u>	<u>\$ 25,602,886</u>

The most significant changes in the District's financial position in 2012 were the decrease in current liabilities due to the repayment of a note payable and an increase in current assets due to growth of short-term investments.

The most significant change in the District's financial position in 2011 was the decrease in patient accounts receivable as the District worked through billing delays caused by implementation of a new computer system in 2010.

Operating Results and Changes in the District's Net Assets

In 2012, the District's net assets increased by \$1,936,323, or 17%, as shown in Table 2. This increase is made up of several different components and represents an increase of approximately \$2,578,000 compared to the decrease in net assets for 2011 of \$641,772. The District's change in net assets decreased from income of \$785,762 in 2010 to a loss of \$641,772 in 2011, a decrease of approximately \$1,428,000.

Table 2: Operating Results and Changes in Net Assets

	2012	2011	2010
Operating Revenues			
Net patient service revenue	\$ 17,875,096	\$ 15,367,515	\$ 18,232,395
Electronic health record revenue	1,358,363	1,775,683	-
Other	488,494	572,387	534,814
Total operating revenues	<u>19,721,953</u>	<u>17,715,585</u>	<u>18,767,209</u>
Operating Expenses			
Salaries and wages and employee benefits	9,297,050	9,720,236	9,563,057
Purchased services and professional fees	4,032,483	4,068,052	3,457,315
Depreciation and amortization	1,404,387	1,227,294	843,615
Other operating expenses	4,110,073	4,217,936	4,209,720
Total operating expenses	<u>18,843,993</u>	<u>19,233,518</u>	<u>18,073,707</u>
Operating Income (Loss)	<u>877,960</u>	<u>(1,517,933)</u>	<u>693,502</u>
Nonoperating Revenues (Expenses)			
Property taxes	587,562	607,555	563,536
Investment income	20,255	36,654	79,213
Noncapital grants and gifts	8,917	83,309	2,721
Interest expense	(564,748)	(621,316)	(607,458)
Contributed services	591,586	761,654	54,248
Total nonoperating revenues (expenses)	<u>643,572</u>	<u>867,856</u>	<u>92,260</u>
Capital grants	<u>414,791</u>	<u>8,305</u>	<u>-</u>
Increase (Decrease) in Net Assets	<u>\$ 1,936,323</u>	<u>\$ (641,772)</u>	<u>\$ 785,762</u>

Operating Income (Loss)

The first component of the overall change in the District's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. The District reported an operating income in 2012 and 2010, but reported a loss in 2011. The District was formed and is operated primarily to serve residents of Hamilton,

Texas and the surrounding area. The District levies property taxes to provide sufficient resources to enable the facility to serve lower income and other residents.

The District operating results improved by \$2,395,893, between 2011 and 2012.

The primary reasons for the switch from a loss in 2011 to income in 2012 are:

- An increase in net patient service revenue of \$2,507,581, or 16%.
- A decrease in salaries and wages and employee benefits for the District's employees of \$423,186, or 4%.

Net patient service revenue increased in 2012 due to increased outpatient and clinic utilization combined with significant improvements in the collection problems that occurred in 2011, as noted below.

The operating loss for 2011 increased by \$2,211,435, or 319%, as compared to 2010. The primary components of the increase in operating loss are:

- A decrease in net patient service revenue of \$2,864,880, or 16%.
- An increase in salaries and wages and employee benefits of \$157,179, or 2%.
- An increase in purchased services and professional fees of \$610,737, or 18%.

Net patient service revenue decreased in 2011 due to an increase in contractual deductions and a decrease in service volumes. Due to miscommunication related to an information system conversion, the District recorded approximately \$2 million of additional contractual allowances related to claims that had passed the required filing deadlines with third-party payers. In addition, net patient service revenue decreased approximately \$700,000 due to decreases in service volumes.

During 2012 and 2011, the District met Medicare's meaningful-use requirements which allowed it to receive incentive payments related to implementation of an electronic medical records system. The District recorded approximately \$1,223,000 and \$1,776,000 in incentive payments during 2012 and 2011, respectively, from the Medicare and Medicaid programs.

Depreciation and amortization increased in 2011 due to the implementation of electronic health records and other equipment additions.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of property taxes levied by the District, investment income, interest expense, noncapital contribution and grants, and contributed services related to the District's participation in the Medicaid Private Upper Payment Limit Program, a program designed to benefit rural community hospitals. Other nonoperating revenue decreased \$224,284 in 2012 due to decreased contributions made to the Medicaid Private Upper Payment Limit Program.

Capital Grants and Gifts

The District receives both capital and operating grants from various state and federal agencies for specific programs. In 2012, the District received two large contributions for the purchase of capital assets.

The District's Cash Flows

Changes in the District's cash flows are consistent with changes in operating losses and nonoperating revenues and expenses for 2012, 2011 and 2010, discussed earlier.

Capital Asset and Debt Administration

Capital Assets

At the end of 2012 and 2011, the District had \$14,431,205 and \$15,371,937, respectively, invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2012, the District purchased new capital assets costing approximately \$459,000. This represents a decrease of approximately \$1.4 million from 2011, when the District purchased its new EHR system.

Debt

At September 30, 2012 and 2011, the District had \$9,553,671 and \$9,864,084, respectively, in revenue bonds, notes payable and capital lease obligations outstanding. The District's only increase in long-term debt during 2012 or 2011 was a new capital lease with a present value of approximately \$54,000 entered in 2012. The District's formal debt issuances, such as revenue bonds, are subject to limitations imposed by state law.

Other Economic Factors

The current protracted economic decline continues to present hospitals with difficult circumstances and challenges. The rising unemployment rate has made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the District's future operating results. Patients are also deferring elective procedures which have impacted revenues. Further, the effect of economic conditions on the federal and state level may have an adverse effect on cash flows related to the Medicare and Medicaid program. The continued implementation of the Section 1115 waiver program by the Texas Medicaid program may have a material impact on the District's Medicaid supplemental program revenue in 2013 and subsequent years.

Contacting the District's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the District's management at Hamilton County Hospital District, 400 North Brown, Hamilton, Texas 76531.

Hamilton County Hospital District
Balance Sheets
September 30, 2012 and 2011

Assets

	<u>2012</u>	<u>2011</u>
Current Assets		
Cash and cash equivalents	\$ 2,554,851	\$ 2,269,244
Short-term investments	1,937,966	19,859
Restricted cash and investments, current	155,884	2,055,757
Patient accounts receivable, net of allowance; 2012 - \$4,206,000, 2011 - \$4,306,000	2,526,660	2,978,797
Property taxes receivable	39,058	32,513
Estimated amounts due from third-party payers	1,291,100	202,802
Supplies	635,665	681,523
Prepaid expenses and other	751,211	928,105
	<u>9,892,395</u>	<u>9,168,600</u>
Noncurrent Cash and Investments		
Held as collateral on line of credit	-	1,906,933
Held by trustee for debt service	155,884	155,732
Held by trustee for self-insurance	58,000	302,979
Restricted by donors	104,634	1,335
	<u>318,518</u>	<u>2,366,979</u>
Less amount required to meet current obligations	155,884	2,055,757
	<u>162,634</u>	<u>311,222</u>
Capital Assets, Net	<u>14,431,205</u>	<u>15,371,937</u>
Other Assets	<u>92,867</u>	<u>98,131</u>
Total assets	<u><u>\$ 24,579,101</u></u>	<u><u>\$ 24,949,890</u></u>

See Notes to Financial Statements

Liabilities and Net Assets

	<u>2012</u>	<u>2011</u>
Current Liabilities		
Notes payable to banks	\$ -	\$ 1,900,025
Current maturities of long-term debt	374,499	361,792
Accounts payable	575,825	658,270
Accrued expenses	<u>967,621</u>	<u>981,850</u>
Total current liabilities	1,917,945	3,901,937
Long-term Debt	<u>9,179,172</u>	<u>9,502,292</u>
Total liabilities	<u>11,097,117</u>	<u>13,404,229</u>
Net Assets		
Invested in capital assets, net of related debt	5,033,418	3,763,560
Restricted-expendable by donors	104,634	1,335
Unrestricted	<u>8,343,932</u>	<u>7,780,766</u>
Total net assets	<u>13,481,984</u>	<u>11,545,661</u>
Total liabilities and net assets	<u>\$ 24,579,101</u>	<u>\$ 24,949,890</u>

Hamilton County Hospital District
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2012 and 2011

	2012	2011
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2012 – \$3,332,000, 2011 – \$2,680,000	\$ 17,875,096	\$ 15,367,515
Electronic health record incentive payments	1,358,363	1,775,683
Other	488,494	572,387
Total operating revenues	19,721,953	17,715,585
Operating Expenses		
Salaries and wages	7,531,691	7,844,542
Employee benefits	1,765,359	1,875,694
Purchased services and professional fees	4,032,483	4,068,052
Supplies and other	4,115,316	4,221,001
Depreciation and amortization	1,404,387	1,227,294
Gain on sale of capital assets	(5,243)	(3,065)
Total operating expenses	18,843,993	19,233,518
Operating Income (Loss)	877,960	(1,517,933)
Nonoperating Revenues (Expenses)		
Property taxes	587,562	607,555
Investment income	20,255	36,654
Interest expense	(564,748)	(621,316)
Contributed services	591,586	761,654
Noncapital grants and gifts	8,917	83,309
Total nonoperating revenues	643,572	867,856
Excess (Deficiency) of Revenues Over Expenses Before Capital Grants and Gifts	1,521,532	(650,077)
Capital Grants and Gifts	414,791	8,305
Increase (Decrease) in Net Assets	1,936,323	(641,772)
Net Assets, Beginning of Year	11,545,661	12,187,433
Net Assets, End of Year	\$ 13,481,984	\$ 11,545,661

Hamilton County Hospital District
Statements of Cash Flows
Years Ended September 30, 2012 and 2011

	2012	2011
Operating Activities		
Receipts from and on behalf of patients	\$ 18,597,298	\$ 17,466,703
Payments to suppliers and contractors	(7,414,162)	(8,351,661)
Payments to employees	(9,360,028)	(9,708,005)
Other receipts, net	537,544	2,305,041
Net cash provided by operating activities	2,360,652	1,712,078
Noncapital Financing Activities		
Property taxes supporting operations	581,017	575,042
Noncapital grants and gifts	8,917	83,309
Net cash provided by noncapital financing activities	589,934	658,351
Capital and Related Financing Activities		
Capital grants and gifts	414,791	8,305
Proceeds from line of credit borrowings	-	500,000
Principal paid on long-term debt	(364,242)	(587,740)
Principal paid on line of credit borrowings	(1,900,025)	-
Interest paid on notes payable to banks and long-term debt	(566,790)	(618,426)
Proceeds from sale of capital assets	5,678	3,065
Purchase of capital assets	(405,000)	(1,850,069)
Net cash used in capital and related financing activities	(2,815,588)	(2,544,865)
Investing Activities		
Interest and dividends on investments	20,255	36,654
Purchases of investments	(11,174)	-
Proceeds from disposition of investments	-	1,213,868
Net cash provided by investing activities	9,081	1,250,522
Increase in Cash and Cash Equivalents	144,079	1,076,086
Cash and Cash Equivalents, Beginning of Year	2,729,290	1,653,204
Cash and Cash Equivalents, End of Year	\$ 2,873,369	\$ 2,729,290

Hamilton County Hospital District
Statements of Cash Flows (Continued)
Years Ended September 30, 2012 and 2011

	2012	2011
Reconciliation of Cash and Cash Equivalents to the Balance Sheets		
Cash and cash equivalents in current assets	\$ 2,554,851	\$ 2,269,244
Cash and cash equivalents in noncurrent cash and investments	318,518	460,046
Total cash and cash equivalents	\$ 2,873,369	\$ 2,729,290
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by (Used in) Operating Activities		
Operating income (loss)	\$ 877,960	\$ (1,517,933)
Depreciation and amortization	1,404,387	1,227,294
Gain on sale of capital assets	(5,243)	(3,065)
Contributed services	591,586	761,654
Changes in operating assets and liabilities:		
Patient accounts receivable	452,137	2,235,333
Estimated amounts due from and to third-party payers	(1,088,298)	(136,145)
Accounts payable and accrued expenses	(94,629)	78,890
Other assets and liabilities	222,752	(933,950)
Net cash provided by operating activities	\$ 2,360,652	\$ 1,712,078
Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets	\$ 53,829	\$ -

Hamilton County Hospital District

Notes to Financial Statements

September 30, 2012 and 2011

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

Nature of Operations and Reporting Entity

Hamilton County Hospital District (the District) is an acute care hospital located in Hamilton, Texas. The District is governed by a Board of Directors elected by citizens residing in the District. The District primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Hamilton County area.

Basis of Accounting and Presentation

The financial statements of the District have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally federal and state grants and county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific, property taxes, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The District first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The District prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the District has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that do not conflict with or contradict GASB pronouncements.

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.

Cash Equivalents

The District considers all liquid investments with original maturities of three months or less to be cash equivalents. At September 30, 2012 and 2011, cash equivalents consisted primarily of money market funds.

Hamilton County Hospital District

Notes to Financial Statements

September 30, 2012 and 2011

Property Taxes

The District received approximately 3% of its financial support from property taxes to support operations in both 2012 and 2011.

Property taxes are levied by the District on October 1 of each year based on the preceding January 1 assessed property values. To secure payment, an enforceable lien attaches to the property on January 1, when the value is assessed. Property taxes become due and payable when levied on October 1. This is the date on which an enforceable legal claim arises and the District records a receivable for the property tax assessment, less an allowance for uncollectible taxes. Property taxes are considered delinquent after January 31 of the following year.

The District's property tax rate was \$0.1607 per \$100 valuation for both 2012 and 2011 and property tax revenue totaled \$587,562 and \$607,555 for 2012 and 2011, respectively.

The allowance for uncollectible taxes of \$1,172 and \$1,006 at September 30, 2012 and 2011, respectively, was computed based on historical collection information and the experience of other similar taxing authorities.

Risk Management

The District 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 medical malpractice claims. Settled claims have not exceeded insurance coverage in any of the three preceding years.

The District is self-insured for a portion of its exposure to risk of loss from medical malpractice and general liability claims. Annual estimated provisions are accrued for the self-insured portion of these claims and include an estimate of the ultimate cost for both reported claims and claims incurred but not yet reported, if any.

Patient Accounts Receivable

The District reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The District 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.

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the District:

Buildings and leasehold improvements	15 – 40 years
Equipment	3 – 20 years

Deferred Financing Costs

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

Compensated Absences

District 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. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. Compensated absence liabilities are computed using a graduated payout scale based on time of service, 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.

Net Assets

Net assets of the District are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the District, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable.

Hamilton County Hospital District

Notes to Financial Statements

September 30, 2012 and 2011

Net Patient Service Revenue

The District has agreements with third-party payers that provide for payments to the District 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.

Charity Care

The District provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the District does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Income Taxes

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

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 incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the District continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the administrative contractor. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The District recognizes revenue at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

Hamilton County Hospital District

Notes to Financial Statements

September 30, 2012 and 2011

In 2012 and 2011, the District met the first and second year requirements under both the Medicare and Medicaid programs and has recorded revenue of approximately \$1,358,000 and \$1,776,000, respectively, which is included within operating revenues in the statement of revenues, expenses and changes in net assets.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 financial statement presentation. The reclassifications had no effect on the changes in financial position.

Note 2: Net Patient Service Revenue

The District has agreements with third-party payers that provide for payments to the District at amounts different from its established rates. These payment arrangements include:

- **Medicare** – Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The District is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare administrative contractor.
- **Medicaid** – Inpatient and outpatient services rendered to traditional Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for all other services. The District is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicaid administrative contractor.

During fiscal year 2010, the District signed an indigent care affiliation agreement with the Service Organization of Central Texas (SOCT), a non-profit corporation, and affiliated hospitals. This agreement is intended to increase funding for the Medicaid population and to access federal funding for the indigent population through the Texas Medicaid Supplemental Payment Program also known as the Private Upper Payment Limit Program. Under this program, the District contributes certain government funds to the State of Texas. The SOCT then provides care to the Medicaid and non-Medicaid indigent in Hamilton County. These services were valued at approximately \$591,586 and \$761,654 for the years 2012 and 2011, respectively. Some of this care was previously provided by the District. As part of the affiliation agreement, the District provided \$1,815,005 and \$1,053,354 in funding to the program for the year ended September 30, 2012 and 2011, respectively.

Hamilton County Hospital District

Notes to Financial Statements

September 30, 2012 and 2011

On December 12, 2011, the United States Department of Health and Human Services approved a new Medicaid section 1115(a) demonstration entitled "Texas Health Transformation and Quality Improvement Program (the Waiver)." The Waiver will expand existing Medicaid managed care programs and establish two funding pools that will assist providers with uncompensated care costs and promote health system transformation. The demonstration is effective from December 12, 2011 to September 30, 2016, and may have a material impact on the District's future Medicaid funding. During 2012, the District received approximately \$214,000 under the Waiver for uncompensated care payments.

During 2011, the District participated in the Medicaid Upper Payment Limit Program (UPL), a program designed to benefit rural community hospitals. As part of the program, twenty-five hospitals meeting specific requirements agreed to advance funds which are then matched with federal funding. Again, based on specific requirements, all funds are then disbursed to rural community hospitals throughout Texas. In connection with this program, the District received approximately \$376,000 during 2011. The UPL program was replaced by the Waiver in 2012.

Approximately 49% and 46% of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended September 30, 2012 and 2011, 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 District has also entered into payment agreements with certain commercial insurance carriers, managed care plans and preferred provider organizations. The basis for payment to the District under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Note 3: Deposits 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 District's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the state of Texas; bonds of any city, county, school district or special road district of the state of Texas; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

At September 30, 2012 and 2011, \$0 and \$875,434, respectively, of the District's bank balances of \$4,811,335 and \$4,800,732 were exposed to custodial credit risk as follows:

	2012	2011
Uninsured and uncollateralized	\$ -	\$ 875,434

All of the District's investments consist of certificates of deposit with initial maturities of one year or less.

Investment Income

Investment income for the years ended September 30, 2012 and 2011, consisted of interest income.

Note 4: Patient Accounts Receivable

The District 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 September 30 consisted of:

	2012	2011
Medicare	\$ 1,167,170	\$ 2,954,625
Medicaid	60,386	269,930
Other third-party payers	910,769	1,855,835
Patients	4,594,478	2,204,550
	6,732,803	7,284,940
Less allowance for uncollectible accounts	4,206,143	4,306,143
	\$ 2,526,660	\$ 2,978,797

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

Note 5: Capital Assets

Capital assets activity for the years ended September 30 was:

	2012				Ending Balance
	Beginning Balance	Additions	Disposals	Transfers	
Land	\$ 174,350	\$ -	\$ -	\$ -	\$ 174,350
Buildings and improvements	13,367,270	167,547	-	957,229	14,492,046
Equipment	7,610,483	237,453	-	-	7,847,936
Leased assets	455,576	53,829	(60,377)	-	449,028
Construction in progress	957,229	-	-	(957,229)	-
	<u>22,564,908</u>	<u>458,829</u>	<u>(60,377)</u>	<u>-</u>	<u>22,963,360</u>
Less accumulated depreciation					
Buildings and improvements	2,210,135	372,064	-	-	2,582,199
Equipment	4,689,073	967,120	-	-	5,656,193
Leased assets	293,763	59,939	(59,939)	-	293,763
	<u>7,192,971</u>	<u>1,399,123</u>	<u>(59,939)</u>	<u>-</u>	<u>8,532,155</u>
Capital assets, net	<u>\$ 15,371,937</u>	<u>\$ (940,294)</u>	<u>\$ (438)</u>	<u>\$ -</u>	<u>\$ 14,431,205</u>
	2011				Ending Balance
	Beginning Balance	Additions	Disposals	Transfers	
Land	\$ 179,429	\$ 6,200	\$ -	\$ (11,279)	\$ 174,350
Buildings and improvements	13,444,095	58,844	-	(135,669)	13,367,270
Equipment	4,672,832	1,785,025	(53,740)	1,206,366	7,610,483
Leased assets	1,058,066	-	-	(602,490)	455,576
Construction in progress	1,414,157	-	-	(456,928)	957,229
	<u>20,768,579</u>	<u>1,850,069</u>	<u>(53,740)</u>	<u>-</u>	<u>22,564,908</u>
Less accumulated depreciation					
Buildings and improvements	1,972,992	287,819	(50,676)	-	2,210,135
Equipment	3,833,177	855,896	-	-	4,689,073
Leased assets	213,249	80,514	-	-	293,763
	<u>6,019,418</u>	<u>1,224,229</u>	<u>(50,676)</u>	<u>-</u>	<u>7,192,971</u>
Capital assets, net	<u>\$ 14,749,161</u>	<u>\$ 625,840</u>	<u>\$ (3,064)</u>	<u>\$ -</u>	<u>\$ 15,371,937</u>

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

Construction in progress at September 30, 2011 included amounts related to an expansion project. The District added eight additional hospital beds and a mammography machine during 2012.

Note 6: Notes Payable to Bank

The District entered into a note payable with a local bank to finance capital assets acquisitions and construction on an interim basis. The note payable bears interest at 3.35%, is collateralized by certificates of deposit, and matures in less than one year from issuance. The following is a summary of short-term notes payable transactions for the years ended September 30:

	<u>2012</u>	<u>2011</u>
Beginning balance	\$ 1,900,025	\$ 1,400,025
Additions	-	500,000
Deductions	<u>(1,900,025)</u>	<u>-</u>
Ending balance	<u>\$ -</u>	<u>\$ 1,900,025</u>

Note 7: Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses included in current liabilities at September 30 consisted of:

	<u>2012</u>	<u>2011</u>
Payable to suppliers and contractors	\$ 575,825	\$ 658,270
Payable to employees (including payroll taxes and benefits)	667,564	680,720
Estimated self-insurance costs, current	212,465	211,493
Payable for interest on debt	<u>87,592</u>	<u>89,637</u>
	<u>\$ 1,543,446</u>	<u>\$ 1,640,120</u>

Note 8: Medical Malpractice and General Liability Claims

The District is a unit of government covered by the Texas Tort Claims Act (Act) which, by statute, limits its liability to \$100,000 per individual and \$300,000 aggregate per claim. The District is self-insured for amounts not covered by the Act. Losses from asserted and unasserted claims identified under the District's incident reporting system are accrued based on estimates that incorporate the District's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. It is reasonably possible that the District's estimate of losses will change by a material amount in the near term.

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

Activity in the District's accrued claims liability during September 30, 2012 and 2011, which is included on the balance sheets as a component of accrued expenses, is summarized as follows:

	<u>2012</u>	<u>2011</u>
Balance, beginning of year	\$ 211,493	\$ 205,663
Current year claims incurred and changes in estimates for claims incurred in prior years	<u>972</u>	<u>5,830</u>
Balance, end of year	<u>\$ 212,465</u>	<u>\$ 211,493</u>

Note 9: Long-term Obligations

The following is a summary of long-term obligation transactions for the District for the years ended September 30:

	<u>2012</u>				
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Long-term debt:					
Revenue bonds payable:					
Series 2003	\$ 5,990,000	\$ -	\$ (125,000)	\$ 5,865,000	\$ 215,000
Series 2007	3,675,000	-	(95,000)	3,580,000	100,000
Notes payable	57,546	-	(57,546)	-	-
Capital lease obligations	<u>141,538</u>	<u>53,829</u>	<u>(86,696)</u>	<u>108,671</u>	<u>59,499</u>
Total long-term debt	<u>\$ 9,864,084</u>	<u>\$ 53,829</u>	<u>\$ (364,242)</u>	<u>\$ 9,553,671</u>	<u>\$ 374,499</u>

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

	2011				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt:					
Revenue bonds payable:					
Series 2003	\$ 6,110,000	\$ -	\$ (120,000)	\$ 5,990,000	\$ 125,000
Series 2007	3,760,000	-	(85,000)	3,675,000	95,000
Notes payable	284,899	-	(227,353)	57,546	57,546
Capital lease obligations	296,925	-	(155,387)	141,538	84,246
Total long-term debt	<u>\$ 10,451,824</u>	<u>\$ -</u>	<u>\$ (587,740)</u>	<u>\$ 9,864,084</u>	<u>\$ 361,792</u>

Revenue Bonds Payable - Series 2003

The Series 2003 revenue bonds payable consist of Revenue Bonds (Series 2003 Bonds) in the original amount of \$6,575,000, dated August 12, 2003, which bear interest at 5.5% through August 1, 2018. The interest rate will be reset to 75% of *The Wall Street Journal* prime rate as it exists on August 1, 2018 and August 1, 2023. The Series 2003 Bonds are payable in annual installments through August 15, 2028. All of the Series 2003 Bonds still outstanding may be redeemed in multiples of \$5,000 without premium at the District's option. The Series 2003 Bonds are secured by the net revenues of the District and the assets restricted under the bond indenture agreement.

Revenue Bonds Payable - Series 2007

The Series 2007 revenue bonds payable consist of Revenue Bonds (Series 2007 Bonds) in the original amount of \$4,000,000, dated October 1, 2007, which bear interest at 5.75% through August 1, 2017. The interest rate will be reset to 75% of *The Wall Street Journal Prime Rate* as it exists on August 1, 2017, August 1, 2022 and August 1, 2027, provided that the rate shall never be less than 4.50% or greater than 7.00%. The Series 2007 Bonds are payable in annual installments through August 1, 2032. All of the Series 2007 Bonds still outstanding may be redeemed in multiples of \$5,000 without premium at the District's option. The Series 2007 Bonds are secured by the net revenues of the District and the assets restricted under the bond indenture agreement.

The indenture agreements require the District to comply with certain restrictive covenants including minimum insurance coverage, maintaining a historical debt-service coverage ratio of at least 125%, and restrictions on incurrence of additional debt.

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

The debt service requirements as of September 30, 2012, are as follows:

Year Ending September 30,	Total to be Paid	Principal	Interest
2013	\$ 837,513	\$ 315,000	\$ 522,513
2014	854,113	350,000	504,113
2015	859,050	375,000	484,050
2016	862,738	400,000	462,738
2017	860,025	420,000	440,025
2018–2022	4,290,025	2,475,000	1,815,025
2023–2027	4,296,525	3,270,000	1,026,525
2028–2032	2,087,725	1,840,000	247,725
	<u>\$ 14,947,714</u>	<u>\$ 9,445,000</u>	<u>\$ 5,502,714</u>

Notes Payable

Notes payable are comprised of various agreements with interest rates ranging from 3.25% to 7.08% and are secured by real property and equipment. Monthly payments on these notes range from \$5,546 to \$7,927. All outstanding notes payable matured in 2012 and were paid in full by the District.

Capital Lease Obligations

The District is obligated under leases for equipment that are accounted for as capital leases. The following is a schedule by year of future minimum lease payments under the capital lease including interest at rates from 0% to 9.56% together with the present value of the future minimum lease payments as of September 30, 2012:

Year Ending September 30,	
2013	\$ 63,872
2014	20,340
2015	12,091
2016	12,091
2017	12,091
Total minimum lease payments	<u>120,485</u>
Less amount representing interest	<u>11,814</u>
Present value of future minimum lease payments	<u>\$ 108,671</u>

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

Note 10: Charity Care

Charges excluded from revenue under the District's charity care policy were \$486,939 and \$802,014 for 2012 and 2011, respectively.

Note 11: Pension Plan

The District contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the District's contributions, determined in accordance with the terms of the plan. The plan is administered by a board of trustees appointed by the Board of Directors. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the District's governing body. Contribution rates for plan members and the District expressed as a percentage of covered payroll were 3.90% and 0% for 2012 and 5.06% and 0% for 2011, respectively. Contributions actually made by plan members and the District aggregated \$101,571 and \$0 during 2012, and \$156,559 and \$0 during 2011, respectively.

Note 12: Risks and Uncertainties

Health Care Reform

During 2010, Congress passed legislation that will significantly reform the health care system in the United States of America. The legislation will require certain changes through 2014 to private and public health care insurance plans. The legislation also calls for an expansion of the Medicaid system as well as reduction in Medicare payments to providers who do not meet certain quality and patient satisfaction metrics, among other reimbursement decreases. While the impact of these regulatory changes cannot currently be determined, it is reasonably possible that these changes will have a significant impact on the District's net patient service revenues and operations.

Hamilton County Hospital District
Notes to Financial Statements
September 30, 2012 and 2011

Note 13: Contingencies

Litigation

In the normal course of business, the District 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 District's self-insurance program (discussed elsewhere in these notes); for example, allegations regarding employment practices or performance of contracts. The District 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 14: Related Party

The District, from time to time, conducts business with organizations that are affiliated with Board members. This is often a result of a limited number of vendors in smaller communities. During 2012 and 2011, the District maintained funds at a bank where a Board member is employed. The District has a conflict of interest policy and the board member has disclosed the relationship.

Note 15: Hamilton General Hospital Healthcare Foundation

Hamilton General Hospital Healthcare Foundation (the Foundation) is a separate tax-exempt organization organized to benefit healthcare services through receiving charitable donations. The Foundation is not presented as a component unit of the District due to its organizational structure. During 2012 and 2011, the District received \$205,000 and \$0, respectively, in donations from the Foundation.