



Financial Statements  
December 31, 2016 and 2015  
**Brookings Health System**

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## Independent Auditor's Report

The Board of Directors  
Brookings Health System  
Brookings, South Dakota

### Report on the Financial Statements

We have audited the accompanying statements of net position and the related statements of revenues, expenses, and changes in net position and statements of cash flows of Brookings Health System (the Organization), an enterprise fund of the City of Brookings, South Dakota, and of its discretely presented component unit as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Organization's basic financial statements.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Organization'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 Organization's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of Brookings Health System, an enterprise fund of the City of Brookings, South Dakota, and its discretely presented component unit as of December 31, 2016 and 2015 and the respective changes in their net position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

## **Emphasis of Matter**

As discussed in Note 1, the financial statements present only Brookings Health System, an enterprise fund of the City of Brookings, South Dakota, and its discretely presented component unit and do not purport to, and do not, present fairly the financial position of the City of Brookings, South Dakota, the changes in its financial position, or where applicable, its cash flows for the years ended December 31, 2016 and 2015 in conformity with accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis on pages 3 through 9, and the Schedules of Funding Progress for the Retiree Health Plan, Pension Contributions, and Proportionate Share of Net Pension Liability (Asset) on pages 40 through 42 be presented to supplement the basic financial statements. Such information, although not a 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 inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued a report dated April 6, 2017 on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.



Sioux Falls, South Dakota  
April 6, 2017

Brookings Health System (the “Health System”) offers readers of our financial statements this narrative overview and analysis of the financial activities of the Health System for the years ended December 31, 2016 and 2015. We encourage readers to consider the information presented here in conjunction with that presented in the audited financial statements and notes to the financial statements which follow this analysis.

### **Overview of the Health System**

Brookings Health System is owned by, and operated as an enterprise fund of, the City of Brookings, South Dakota. The health system includes the following:

- Brookings Hospital, a 49-bed general acute care hospital
- Brookings Clinic, a multispecialty clinic operated in partnership with Avera Medical Group that includes over 30 physicians and other providers
- Home Health and Hospice
- The Neighborhoods at Brookview, a 79-bed skilled nursing facility located on the hospital campus
- Brookhaven Estates, a 25-unit congregate apartment facility for seniors located on the hospital campus
- Three rural health clinics in Arlington, Volga, and White, South Dakota
- Yorkshire Eye Clinic, an ophthalmology clinic adjacent to the hospital campus

The health system broke ground on a three-part expansion/renovation in 2015 which included the following:

- A two-story 24,000 square foot medical office building, the Medical Plaza. The first floor will house specialty physicians and the second floor will be for future development. A majority of this space was placed in service in late 2016 with final completion in 2017.
- A two-story 62,500 square foot addition to Brookings Hospital including new and enhanced areas for surgery, imaging, inpatient, and obstetric care. Specific improvements include additional operating suites and an adjoining same day surgery area, MRI machine housed in the building, private inpatient rooms, and new labor, delivery, recovery, and postpartum rooms. This will be placed in service in spring 2017.
- Renovation of 17,500 square feet in the existing hospital to provide more efficient space for administrative and support staff, including the relocation of some off-site staff into the main campus. The renovation is scheduled to be completed in Fall 2017.

The Health System is supported by the Brookings Health System Foundation, a not-for-profit entity established to support Brookings Health System through philanthropy. The Foundation conducted a Progress Lives Here capital campaign which concluded in February 2016 and raised approximately \$4.6 million to help fund the expansion/renovation. In December 2016, the Foundation gave the hospital approximately \$2 million.

### **Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to Brookings Health System’s audited financial statements. The financial statements are composed of the statement of net position (balance sheet), statement of revenues, expenses, and changes in net position, and statement of cash flows. The financial statements also include notes to the financial statements that explain in more detail some of the information in the financial statements. The financial statements are designed to provide readers with a broad overview of our financial position.

Because Brookings Health System is owned by the City of Brookings, audited financial statements comply with accounting standards set by the Governmental Accounting Standards Board (GASB).

### **Required Financial Statements**

The financial statements provide information about Brookings Health System using accounting methods with some similarities to those used by private sector healthcare organizations. These statements offer short- and long-term information about our activities. The statements of net position includes all of our assets, liabilities, and deferred inflows/outflows of resources and provides information about the nature and amounts of our investments in resources (assets and deferred outflows of resources) and the obligations to our creditors (liabilities and deferred inflows of resources). The statements of net position also provides the basis for evaluating our capital structure and assessing our liquidity and financial flexibility.

All of our current year's revenues and expenses are accounted for in the statements of revenues, expenses, and changes in net position. These statements measures the success of our operations over the past two years and can be used to determine whether or not we have successfully recovered all of our costs through patient service revenue and other revenue sources. Revenues and expenses are reported on an accrual basis, which means the related cash could be received or paid in a subsequent period.

The final required statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and non-capital activities, and capital and capital related financing activities. It also provides answers to such questions as where cash came from, what it was used for, and what the change in the cash balance was during the reporting period.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

### **Financial Highlights for 2016**

- Assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources for a net position of \$66,303,191 for the calendar year reported. That was an increase of \$4,893,495, or 8.0%, over 2015's net position of \$61,409,696.
- Net capital assets increased \$27,798,471, primarily due to construction in progress for the hospital expansion and renovation.
- Noncurrent investments decreased from \$14,490,227 to \$2,127,944. As investments matured they were converted to cash to help pay for the hospital expansion and renovation.
- Long-term debt (including the current maturities of long-term debt) increased from \$9,789,843 in 2015 to \$21,776,924 due to borrowings related to the hospital expansion and renovation. A total of \$30 million was secured through two Certificates of Participation with two local banks and so far \$12,489,179 of that \$30 million has been borrowed.
- Operating margin for 2016 was \$2,757,350 or 4.63%, greater than the budgeted margin of \$2,644,668, but less than 2015's margin of \$8,871,816.

### **Financial Highlights for 2015**

- Assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources for a net position of approximately \$61.4 million for 2015. That was an increase over 2014's restated net position of \$53.4 million.
- Operating margin for 2015 was approximately \$8.9 million and the overall increase in net position was approximately \$8 million.

**Statements of Net Position**

Condensed statements of net position for December 31, 2016 and 2015 are presented below.

	2016	2015
Current Assets		
Cash and cash equivalents	\$ 22,192,151	\$ 15,807,290
Receivables, net	10,160,775	10,533,408
Other current assets	1,442,464	1,434,134
Total current assets	33,795,390	27,774,832
Noncurrent Investments	2,127,944	14,490,227
Capital Assets, net	61,732,854	33,934,383
Other Assets		
Pension Asset	-	3,871,106
Other noncurrent assets	359,946	247,931
Total other assets	359,946	4,119,037
Total assets	98,016,134	80,318,479
Deferred Outflow of Resources - Pension	6,864,868	4,442,649
	\$ 104,881,002	\$ 84,761,128
Current Liabilities		
Current maturities of long-term debt	\$ 688,566	\$ 222,098
Accounts payable		
Trade	9,052,180	5,576,531
Estimated third-party payor settlements	456,200	568,031
Accrued expenses and other current liabilities	2,530,135	2,403,620
Total current liabilities	12,727,081	8,770,280
Long-Term Debt	21,088,358	9,567,745
Amounts Due Under Joint Operating Agreements	958,735	958,734
Net Pension Liability	3,063,462	-
Postretirement Benefits Liability and Compensated Absences	740,175	707,575
Total liabilities	38,577,811	20,004,334
Deferred Inflow of Resources - Pension	-	3,347,098
Net Position		
Invested in capital assets	36,944,758	23,313,066
Restricted - expendable for debt service	133,534	133,534
Restricted - pension benefits	3,801,406	4,966,657
Unrestricted	25,423,493	32,996,439
Total net position	66,303,191	61,409,696
	\$ 104,881,002	\$ 84,761,128

### Debt Administration and Capital Asset Activity

Long-term debt as of December 31, 2016 and 2015 consists primarily of Certificates of Participation (COP) rather than traditional mortgage-based debt instruments. COP A, for \$8 million, and COP B, for \$22 million, were issued in December 2015; at year-end 2016 the total borrowed on these was \$8 million and \$4,489,179, respectively. The proceeds were used, along with funds provided from the Brookings Health System Foundation, sales of investments, and cash from operations, to pay for the new \$50 million hospital expansion and renovation, scheduled to be completed around August 2017. As of year-end 2016, approximately \$33 million had been expended for the project and related equipment, resulting in capital assets increasing by approximately \$28 million.

### Statements of Revenues, Expenses, and Changes in Net Position

Condensed statements of revenues, expenses, and changes in net position for the years ended December 31, 2016 and 2015 are presented below.

	2016	2015
Operating Revenues		
Net patient and resident service revenue	\$ 58,556,852	\$ 60,406,190
Other revenue	1,041,638	1,476,582
Total revenues, gains, and other support	59,598,490	61,882,772
Operating Expenses		
Salaries, wages, and benefits	32,511,146	28,975,903
Supplies and other	20,906,787	20,593,704
Depreciation and amortization	3,423,207	3,441,349
Total operating expenses	56,841,140	53,010,956
Operating Income	2,757,350	8,871,816
Nonoperating Revenues (Expenses)		
Investment income	122,228	285,821
Interest expense and financing costs	(2,795)	(597,462)
Equity interest in income of joint venture	148,779	91,051
Noncapital grants and contributions	20,766	20,112
Other	(173,248)	(761,591)
Total nonoperating revenues (expenses), net	115,730	(962,069)
Revenues in Excess of Expenses	2,873,080	7,909,747
Grants and Contributions for Capital Assets	2,020,415	92,955
Increase in Net Position	4,893,495	8,002,702
Net Position, Beginning of Year	61,409,696	53,406,994
Net Position, End of Year	\$ 66,303,191	\$ 61,409,696



- Gross charges were down 2.2% from 2015, primarily in inpatient areas. Acute admissions decreased from 1,209 in 2015 to 1,132 in 2016.
- Total deductions from revenue were also down accordingly, but net operating revenues were down \$2,284,282, 1.4% under budget, and 3.7% under 2015. See “Payor Mix” below for more details regarding the mix of patients served.
- Salaries and wages were 6.0% over 2015, primarily due to the addition of new providers, but 2.4% under budget.
- Benefits were up primarily due to 2015 pension expense under GASB 68 being \$431,621 compared to \$2,249,556 in 2016. These adjustments are provided by the state pension plan and are based on the Health System’s respective share of pension plan’s assets and actuarially-determined expected payouts and earnings based on the plan measurement period of June 30, 2016.

### Statements of Cash Flows

Condensed statements of cash flows for the years ended December 31, 2016 and 2015, are presented below.

	2016	2015
Operating Activities		
Receipts from and on behalf of patients and residents	\$ 58,781,570	\$ 59,793,733
Payments to suppliers and contractors	(19,761,938)	(22,166,152)
Payments to and on behalf of employees	(31,188,907)	(29,412,352)
Other receipts and payments, net	1,082,882	1,072,633
Net Cash from Operating Activities	8,913,607	9,287,862
Net Cash used for Noncapital Financing Activities	(155,108)	(208,103)
Capital and Capital Related Financing Activities		
Proceeds from issuance of long-term debt	12,209,179	280,000
Debt service and financing costs	(610,984)	(814,136)
Capital grants and contributions	2,019,220	71,943
Purchase of capital assets	(28,655,101)	(4,955,522)
Net Cash used for Capital and Capital Related Financing Activities	(15,037,686)	(5,417,715)
Investing Activities		
Interest and dividends received	111,874	190,342
Investment activity, net	6,982,480	7,001,440
Joint venture activity, net	167,321	(575,848)
Net Cash from Investing Activities	7,261,675	6,615,934
Net Increase in Cash and Cash Equivalents	982,488	10,277,978
Cash and Cash Equivalents, Beginning of Year	21,343,197	11,065,219
Cash and Cash Equivalents, End of Year	\$ 22,325,685	\$ 21,343,197

Unrestricted investments decreased from \$14,356,693 to \$1,994,410 because they were converted to cash to use for the expansion project as they matured. Purchases of fixed assets and borrowings were up due to the expansion project.

### Payor Mix

Brookings Health System's main payors on a gross charge basis were as follows during the years ended December 31, 2016 and 2015:

	2016	2015
Medicare	42%	41%
Medicaid	7%	7%
Blue Cross	24%	25%
Other	27%	27%

\*Other includes self-pay and all other payors.

### Economic Outlook and Next Year's Budget

There are several outside factors that can have major impacts on the Organization's financial success that at this time are still unknown or unmeasurable. The biggest of these is the new federal administration and the future of the Affordable Care Act (ACA), also known as Obamacare. The ACA includes several provisions that had significant impact on healthcare across the country, including Medicaid expansion, which South Dakota has not participated in, and the requirement for everyone to have health insurance or be subject to penalty.

Another potential impact on the Organization's financial success is the Rural Community Hospital Demonstration (RCHD) project. This project allowed hospitals our size to get cost recovery for inpatient Medicare patients. The program, which historically increased our Medicare inpatient revenues by approximately \$1.5 million annually was terminated on October 1, 2015. The 21<sup>st</sup> Century Cures Act passed by the House in late November and the Senate in early December 2016 included a 5-year extension of the program. However, no details on the extension are yet available. When our participation in the RCHD ended, we filed for a low-volume payment adjustment which recovers approximately \$500,000 of the \$1.5 million each year. At this time we are not sure how the RCHD will be implemented going forward. Because we cannot reliably predict how it will be implemented, we have not accrued any potential impacts on our financial statements for the year ended December 31, 2016.

A third external unknown is the commercial insurance market in our area. In 2016, DakotaCare was purchased by Avera Health and subsequently both DakotaCare and the Sanford Health Plans began tightening their networks. At this time, as an independent city-owned hospital we are still participating in each of these health plans. Wellmark, the Blue Cross Blue Shield Plan for both South Dakota and Iowa, is the only major insurer offering "open network" insurance products where patients are not restricted in their choice of providers. This resulted in Wellmark capturing a larger percentage of groups offering employee health insurance in the Brookings area as those groups renewed their coverage in January 2017. At this time it is difficult to predict how much of a change in reimbursement we will encounter as a result of this insurance market activity.

The 2017 operating budget also has several internal impacts that are significant. The \$50 million expansion and renovation project will be completed around August 2017; until then interest costs are mostly being capitalized as part of the building costs. Once the project is completed, both interest and depreciation expense will increase compared to prior years.

Brookings Health System has implemented a hospitalist program in February 2017. Hospitalists work only in the hospital and are able to spend more physician time at the patients' bedside. We expect the change to hospitalists, in conjunction with the new inpatient area opening in February 2017, to increase our average daily inpatient census. In general, other patient care areas, especially ancillary departments and surgery, are also expected to see increases due to the new building expansion and renovation.

The net impact of additional utilization combined with expected changes in insurer payments is overall net patient revenues budgeted to be \$63,286,673 in 2017 compared to \$58,556,852 in 2016, approximately 8% growth.

Total operating expenses for 2017 are budgeted at \$61,827,711 compared to \$56,841,140 in 2016. Much of the increase is due to hiring of hospitalists and other physicians. Salaries are expected to increase approximately 8%.

Benefits are projected approximately 6.5% higher in 2017 compared to 2016. Much of the increase is related to the additional salaries. Health insurance premiums for employees have not been impacted significantly for the past two years. To help keep employee health insurance affordable, Brookings Health System switched from a fully insured insurance product to a self-funded plan through a captive group on January 1, 2017. By participating in a captive group, our employees gain the advantages of being part of a much larger pool which reduces the cost of stop-loss insurance and reduces actuarial risk.

Most of the remaining increase in expenses is due to increased interest and depreciation expense.

Net operating income (margin) for 2017 of \$2,583,835 (4%) is expected compared to \$2,757,350 (4.6%) in 2016.

### **Patient Satisfaction**

Brookings Health System participates in HCAHPS, the Hospital Consumer Assessment of Healthcare Providers and Systems, survey which is required by the Centers for Medicare and Medicaid Services. In 2016, mail surveys were conducted by the National Research Corporation through June. Starting in July, phone surveys were conducted by HealthStream instead as phone surveys tend to result in faster turnaround and increased response rates. We hope that more responses will help guide us to meet our mission of providing high quality, compassionate, personalized health care.

### **Community Benefit**

Brookings Health System provides numerous benefits to the Brookings community and surrounding area. Between financial assistance, government shortfalls, and programs provided to the community without receiving compensating revenue, the community receives nearly \$9 million in community benefits from us each year. In addition, a 2016 South Dakota State University study showed that the Brookings Health System had a \$35 million positive economic impact on Brookings County.

### **Contacting Brookings Health System Financial Management**

This financial report is designed to provide our customers, creditors, and stakeholders with a general overview of our finances and to demonstrate our accountability for the monies we receive. If you have questions about this report or need additional information, contact the Brookings Health System, Attn: Finance, 300 22<sup>nd</sup> Ave S, Brookings, SD 57006.

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	2016	2015
<b>Assets and Deferred Outflows of Resources</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 22,192,151	\$ 15,807,290
Receivables		
Patient and resident, net of estimated uncollectibles of \$3,415,000 in 2016 and \$2,381,000 in 2015	10,098,552	10,429,941
Other	62,223	103,467
Interest	4,902	17,118
Supplies	1,174,360	1,136,537
Prepaid expenses	263,202	280,479
<b>Total current assets</b>	<b>33,795,390</b>	<b>27,774,832</b>
<b>Noncurrent Cash and Investments</b>		
Internally designated by Board for capital improvements	-	9,368,043
Cash held in trust for debt service	133,534	133,534
Other long-term investments	1,994,410	4,988,650
<b>Total noncurrent cash and investments</b>	<b>2,127,944</b>	<b>14,490,227</b>
<b>Capital Assets</b>		
Land	1,617,996	1,617,996
Depreciable capital and intangible assets, net of accumulated depreciation and amortization	32,035,522	27,495,084
Construction in progress	28,079,336	4,821,303
<b>Total capital assets, net</b>	<b>61,732,854</b>	<b>33,934,383</b>
<b>Other Assets</b>		
Investment in joint venture	218,279	236,820
Net pension asset	-	3,871,106
Other receivables	141,667	11,111
<b>Total other assets</b>	<b>359,946</b>	<b>4,119,037</b>
<b>Total assets</b>	<b>98,016,134</b>	<b>80,318,479</b>
<b>Deferred Outflows of Resources</b>		
Related to pension	6,864,868	4,442,649
<b>Total assets and deferred outflows of resources</b>	<b>\$ 104,881,002</b>	<b>\$ 84,761,128</b>

See Notes to Financial Statements

Brookings Health System  
Statements of Net Position  
December 31, 2016 and 2015

	2016	2015
Liabilities, Deferred Inflows of Resources, and Net Position		
Current Liabilities		
Current maturities of long-term debt	\$ 688,566	\$ 222,098
Accounts payable		
Trade	9,052,180	5,576,531
Estimated third-party payor settlements	456,200	568,031
Accrued expenses		
Salaries and wages	1,251,504	1,225,023
Compensated absences	810,281	789,446
Interest	76,856	78,694
Payroll taxes and other	343,636	266,564
Deposits	39,459	34,299
Unearned revenue	8,399	9,594
	12,727,081	8,770,280
Long-Term Debt, Less Current Maturities	21,088,358	9,567,745
Other Noncurrent Liabilities		
Compensated absences	202,000	239,000
Amounts due under joint operating agreements	958,735	958,734
Net pension liability	3,063,462	-
Post-employment benefit liability	538,175	468,575
	4,762,372	1,666,309
Total liabilities	38,577,811	20,004,334
Deferred Inflows of Resources		
Related to pension	-	3,347,098
Net Position		
Net investment in capital assets	36,944,758	23,313,066
Restricted - expendable for debt service	133,534	133,534
Restricted - pension benefits	3,801,406	4,966,657
Unrestricted	25,423,493	32,996,439
	66,303,191	61,409,696
Total net position	66,303,191	61,409,696
Total liabilities, deferred inflows of resources, and net position	\$ 104,881,002	\$ 84,761,128

Brookings Health System Foundation  
 Brookings Health System Foundation Balance Sheets  
 December 31, 2016 and 2015

	2016	2015
Assets		
Current Assets		
Cash and cash equivalents	\$ 226,802	\$ 148,849
Restricted cash - by donors	629,544	894,129
Contributions receivable, net	280,663	1,527,334
Total current assets	1,137,009	2,570,312
Other Assets		
Contributions receivable, net	1,339,514	1,533,835
Total assets	\$ 2,476,523	\$ 4,104,147
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	\$ 4,915	\$ -
Accrued expenses	3,159	2,129
Total current liabilities	8,074	2,129
Net Assets		
Unrestricted	218,729	146,720
Temporarily restricted	2,249,720	3,955,298
Total net assets	2,468,449	4,102,018
Total liabilities and net assets	\$ 2,476,523	\$ 4,104,147

**Brookings Health System**  
**Statements of Revenues, Expenses, and Changes in Net Position**  
**Years Ended December 31, 2016 and 2015**

	2016	2015
Operating Revenues		
Net patient and resident service revenue (net of provision for bad debts of \$3,560,611 in 2016 and \$2,945,352 in 2015)	\$ 58,556,852	\$ 60,406,190
Other revenue	1,041,638	1,476,582
Total revenues, gains, and other support	59,598,490	61,882,772
Operating Expenses		
Salaries and wages	27,654,995	26,090,390
Employee benefits	4,856,151	2,885,513
Supplies and other	20,554,310	20,254,732
Depreciation and amortization	3,423,207	3,441,349
Insurance	352,477	338,972
Total operating expenses	56,841,140	53,010,956
Operating Income	2,757,350	8,871,816
Nonoperating Revenues (Expenses)		
Investment income	122,228	285,821
Interest expense and financing costs	(2,795)	(597,462)
Equity interest in income of joint venture	148,779	91,051
Noncapital grants and contributions	20,766	20,112
Foundation transfers and other	(175,874)	(704,694)
Gain (loss) on disposal of property and equipment	2,626	(56,897)
Nonoperating revenues (expenses), net	115,730	(962,069)
Revenues in Excess of Expenses	2,873,080	7,909,747
Grants and Contributions for Capital Assets	2,020,415	92,955
Increase in Net Position	4,893,495	8,002,702
Net Position, Beginning of Year	61,409,696	53,406,994
Net Position, End of Year	\$ 66,303,191	\$ 61,409,696



Brookings Health System Foundation  
 Brookings Health System Foundation Statements of Activities and Changes in Net Assets  
 Years Ended December 31, 2016 and 2015

	2016	2015
Unrestricted Net Assets		
Support and revenue		
Contributions	\$ 73,837	\$ 700,186
Net assets released from restrictions	2,122,750	96,101
Other	1,020	324
Total support and revenue	2,197,607	796,611
Expenses		
General services and administration	100,442	356,524
Other distributions	3,217	-
Distributions to Brookings Health System	2,021,939	96,101
Total expenses	2,125,598	452,625
Increase in Unrestricted Net Assets	72,009	343,986
Changes in Temporarily Restricted Net Assets		
Contributions for a specific purpose	417,172	3,837,238
Net assets released from restrictions	(2,122,750)	(96,101)
(Decrease) Increase in Temporarily Restricted Net Assets	(1,705,578)	3,741,137
Change in Net Assets	(1,633,569)	4,085,123
Net Assets, Beginning of Year	4,102,018	16,895
Net Assets, End of Year	\$ 2,468,449	\$ 4,102,018

Brookings Health System  
Statements of Cash Flows  
Years Ended December 31, 2016 and 2015

	2016	2015
Operating Activities		
Receipts from and on behalf of patients and residents	\$ 58,781,570	\$ 59,793,733
Payments to suppliers and contractors	(19,761,938)	(22,166,152)
Payments to and on behalf of employees	(31,188,907)	(29,412,352)
Other receipts and payments, net	1,082,882	1,072,633
Net Cash from Operating Activities	8,913,607	9,287,862
Noncapital Financing Activities		
Contributions to foundation	(175,874)	(228,215)
Noncapital grants and contributions	20,766	20,112
Net Cash used for Noncapital Financing Activities	(155,108)	(208,103)
Capital and Capital Related Financing Activities		
Proceeds from issuance of long-term debt	12,209,179	280,000
Principal payments on long-term debt	(222,098)	(214,896)
Capital grants and contributions	2,019,220	71,943
Interest payments on long-term debt	(388,886)	(319,240)
Payments of financing costs	-	(280,000)
Purchase of capital assets	(28,655,101)	(4,955,522)
Net Cash used for Capital and Capital Related Financing Activities	(15,037,686)	(5,417,715)
Investing Activities		
Interest and dividends received	111,874	190,342
Proceeds from sales and maturities of investments	6,982,480	8,001,440
Purchases of investments	-	(1,000,000)
Distribution received from joint venture	167,321	-
Cash distributed to joint operating agreement partner	-	(575,848)
Net Cash from Investing Activities	7,261,675	6,615,934
Net Increase in Cash and Cash Equivalents	982,488	10,277,978
Cash and Cash Equivalents, Beginning of Year	21,343,197	11,065,219
Cash and Cash Equivalents, End of Year	\$ 22,325,685	\$ 21,343,197
Reconciliation of Cash and Cash Equivalents to the Statement of Net Position		
Cash and cash equivalents in current assets	\$ 22,192,151	\$ 15,807,290
Board designated cash and cash equivalents	-	5,402,373
Cash held in trust for debt service	133,534	133,534
Total cash and cash equivalents	\$ 22,325,685	\$ 21,343,197

Brookings Health System  
Statements of Cash Flows  
Years Ended December 31, 2016 and 2015

	2016	2015
Reconciliation of Operating Income to Net Cash from Operating Activities		
Operating income	\$ 2,757,350	\$ 8,871,816
Adjustments to reconcile operating income to net cash from operating activities		
Depreciation and amortization	3,423,207	3,441,349
Provision for bad debts	3,560,611	2,945,352
Change in assets and liabilities		
Patient receivables	(3,229,222)	(4,659,450)
Other receivables	(89,312)	54,737
Supplies	(37,823)	(150,638)
Prepaid expenses	17,277	32,063
Change in deferred inflows and outflows of resources and net pension liability/asset	1,165,251	(571,127)
Trade accounts payable	1,295,951	(1,470,540)
Estimated third-party payor settlements	(111,831)	658,850
Accrued expenses	156,988	134,678
Deposits	5,160	772
Net Cash from Operating Activities	\$ 8,913,607	\$ 9,287,862
Supplemental Disclosures of Non-cash Investing and Financing Activities		
Accounts payable for capital assets	\$ 3,011,172	\$ 831,474

## **Note 1 - Reporting Entity and Summary of Significant Accounting Policies**

The financial statements of the Brookings Health System (Organization) have been prepared in accordance with generally accepted accounting principles in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The significant accounting and reporting policies and practices used by the Organization are described below.

### **Reporting Entity**

The Organization operates a 49-bed hospital, a 79-bed nursing home, a 25-unit congregate living center, and various medical clinics. The Organization is owned and operated as an enterprise fund of the City of Brookings, South Dakota. These financial statements present only the operations of the Health System and its discretely presented component unit. Financial statements for the City of Brookings are prepared under separate cover.

For financial reporting purposes, the Organization has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Organization are such that the exclusion would cause the Organization's financial situation to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Organization to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the Organization.

### **Discretely Presented Component Unit – Brookings Health System Foundation**

Brookings Health System Foundation (Foundation) is a legally separate, tax-exempt component unit of the Organization. Although the Organization does not control the timing or amount of receipts from the Foundation, the majority of the resources, or income thereon, are restricted to the activities of the Organization by the donors. Because these restricted resources held by the Foundation are primarily to be used by, or for the benefit of the Organization, the Foundation is considered a component unit of the Organization and is discretely presented in the Organization's financial statements.

During the years ended December 31, 2016 and 2015, the Foundation distributed approximately \$2,022,000 and \$96,000, respectively, to the Organization to fund its operations and capital projects.

The Foundation is a private not-for-profit organization that reports under the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), including ASC Topic 958, *Not-for-Profit Entities*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation's statements in the Foundation's financial reporting entity for these differences.

### **Measurement Focus and Basis of Accounting**

Measurement focus refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of measurement focus applied.

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized when earned, and expenses are recorded when the liability is incurred.

### **Basis of Presentation**

The statements of net position displays the Organization's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference reported as net position. Net position is reported in the following categories/components:

*Net investment in capital assets* consists of net capital assets reduced by the outstanding balances of any related debt obligations and deferred inflows of resources attributable to the acquisition, construction or improvement of those assets or the related debt obligations and increased by balances of deferred outflows of resources related to those assets or debt obligations.

*Restricted net position:*

*Expendable* - Expendable net position results when constraints placed on net position use are either externally imposed or imposed through enabling legislation.

*Nonexpendable* - Nonexpendable net position is subject to externally imposed stipulations which require them to be maintained permanently by the Organization.

*Unrestricted net position* consists of net position not meeting the definition of the preceding categories. Unrestricted net position often has constraints on resources imposed by management which can be removed or modified.

When an expense is incurred that can be paid using either restricted or unrestricted resources (net position), the Organization's policy is to first apply the expense toward the most restrictive resources and then toward unrestricted resources.

### **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **Cash and Cash Equivalents**

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less.

### **Patient and Resident Receivables**

Patient and resident receivables are uncollateralized patient, resident and third-party payor obligations. Unpaid patient and resident receivables, excluding amounts due from third-party payors, have interest assessed at 1¼ percent per month at the discretion of the business office. Due to the uncertainty of collecting private pay accounts, these interest charges are recognized as revenue when received. Payments of patient and resident receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient and resident receivables is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected from patients, residents, and third-party payors. Management reviews patient and resident receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients and residents due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision. Management also reviews accounts to determine if classification as charity care is appropriate.

### **Physician Loans Receivable**

Physician loans receivable are uncollateralized notes receivable issued to certain physician employees at market values as part of its physician recruitment process or in physician practice acquisitions. The notes are issued with forgiveness provisions that match the work commitment to encourage retention. Management reviews all notes receivable periodically and estimates a portion, if any, of the balance that will not be collected or earned under the work commitment arrangement. There was no allowance as of December 31, 2016 and 2015. Physician loans receivable are included in other receivables in the statements of net position.

### **Supplies**

Supplies are valued at lower of average cost or market and are expensed when used.

### **Noncurrent Cash and Investments**

Noncurrent cash and investments are set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, restricted by trustee for debt reserve, and other long-term investments. All investments are measured at fair value.

### **Investment Income**

Interest, dividends, gains and losses, both realized and unrealized, on investments and deposits are included in nonoperating revenue when earned.

### Capital Assets

Capital asset acquisitions in excess of \$3,000 are capitalized and recorded at historical cost, or in the case of capital leases, based on the present value of future lease payments. Contributed capital assets are reported at their estimated fair value at the time of their donation. Intangible assets are amortized over their estimated economic life. All capital assets other than land and construction in progress are depreciated using the straight-line method of depreciation. The estimated useful lives of capital assets are as follows:

Land improvements	10-40 years
Buildings and improvements	5-45 years
Equipment	3-20 years

### Costs of Borrowing

The Organization capitalized as part of the costs of acquiring capital assets the interest cost on borrowed funds during the period of construction of capital assets. Capitalized interest was \$384,253 and \$1,193 for the years ended December 31, 2016 and 2015, respectively.

### Investment in Joint Ventures

The Organization records its interest in investments where the Organization has a twenty to fifty percent interest in a corporation under the equity method of accounting. Under the equity method, original investments are recorded at cost and adjusted for the Organization's share of undistributed earnings or losses and distributions. The Organization's share of net earnings or losses of the entities is included in nonoperating revenues (expenses).

### Deferred Outflows of Resources

Deferred outflows of resources represent a consumption of net position that applies to future periods and will not be recognized as an outflow of resources (expense) until then. The Organization's deferred outflows of resources consist of unrecognized items not yet charged to pension expense and contributions from the employer after the measurement date but before the end of the employer's reporting period.

### Compensated Absences

The Organization's employees earn vacation at varying rates depending on years of service. Employees also earn sick leave benefits based on varying rates depending on years of service. Sick leave benefits are not paid upon termination or leaving employment, thus are not accrued as liabilities in the financial statements.

### Post-Employment Benefits

The Organization provides post-employment health insurance benefits. The Organization provides access to its health insurance program for certain retired employees that meet participation requirements based on age and employment tenure. Benefits are provided until the retiree reaches age 65. The benefit plan provides access to health benefits, but the premium payments are the responsibility of the retiree. An actuarial determined net post-employment benefit obligation liability has been recorded to account for the implicit subsidy provided under the benefit plan (Note 9).

## **Pensions**

For purposes of measuring the net pension asset, deferred outflows of resources and deferred inflows of resources related to pensions, and net pension expense, information about the fiduciary net position of the South Dakota Retirement System (SDRS) and additions to/deletions from SDRS's fiduciary net position have been determined on the same basis as they are reported by SDRS. The Organizations contributions and net pension (liability) asset are recognized on an accrual basis of accounting.

## **Deferred Inflows of Resources**

Deferred inflows of resources represent an acquisition of net position that applies to a future period(s) and will not be recognized as an inflow of resources (revenue) until that time. The Organization's deferred inflows of resources consist of unrecognized items not yet charged to pension expense.

## **Operating Revenues and Expenses**

The Organization's statements of revenues, expenses and changes in net position distinguish between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, the Organization's principal activity. Nonexchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

## **Net Patient and Resident Service Revenue**

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

## **Charity Care**

The Organization provides care to patients and residents who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient and resident service revenue. The Organization maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. The amounts of charges foregone, based on established rates, were approximately \$366,000 and \$414,000 for the years ended December 31, 2016 and 2015, respectively. The direct and indirect costs related to these foregone charges were \$174,000 and \$189,000 at December 31, 2016 and 2015, respectively, based on the average ratio of cost to gross charges.



### **Grants and Contributions**

The Organization may receive grants as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenues. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses.

### **Risk Management**

The Organization is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. Medical malpractice insurance is discussed in Note 12.

### **Electronic Health Record (EHR) Incentive Payments**

The American Recovery and Reinvestment Act of 2009 (“ARRA”) established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (“EHR”) technology. The Medicare incentive payments are paid out to qualifying hospitals over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals and physicians must meet EHR “meaningful use” criteria that become more stringent over three stages as determined by the Centers for Medicare & Medicaid Services (CMS).

During the years ended December 31, 2016 and 2015, the Organization recorded \$19,257 and \$442,019, respectively, related to the Medicare and Medicaid programs, in other operating revenue for meaningful use incentives. These incentives have been recognized into income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria. Amounts recognized represent management’s best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in other operating revenue in the period in which additional information is available. Such estimates are subject to audit by the federal government or its designee.

### **New Accounting Pronouncement**

The Organization adopted the provisions of GASB Statement No. 72, Fair Value Measurement and Application (GASB 72), during the year ended December 31, 2016. GASB 72 addresses the accounting and financial reporting issues related to fair value measurements. GASB 72 provides guidance for determining a fair value measurement for financial reporting purposes, and provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The adoption of GASB 72 expanded the Medical Center’s investment disclosure in Note 3.

### **Reclassifications**

Reclassifications have been made to the December 31, 2015 financial information to make it conform to the current year presentation. The reclassifications had no effect on previously reported operating results or changes in net position.

## Note 2 - Net Patient and Resident Service Revenue

The Organization has agreements with third-party payors that provide for payments to the Organization at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

**Medicare** - During 2009, the Organization began participation in the Centers for Medicare and Medicaid Services (CMS) Rural Community Hospital Demonstration Program (RCHD) as mandated under Section 410A of the Medicare Modernization Act. For inpatient services provided to patients after January 1, 2009, the Organization is reimbursed on a cost-based methodology subject to retrospective settlement within prescribed limits compared to their initial year base costs under the program. The RCHD program concluded on September 30, 2015 and was extended through federal legislation in December 2016. The effective date of reimbursement changes in connection with the extended RCHD program have not been determined. Beginning October 1, 2015, inpatient acute care services rendered to Hospital Medicare program beneficiaries were paid at prospectively determined rates per discharge. These rates varied according to a patient classification system that was based on clinical, diagnostic, and other factors. The Organization is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Organization and audits thereof by the Medicare Administrative Contractor. The Organization's Medicare cost reports have been audited by the Medicare Administrative Contractor through the year ended December 31, 2013.

**Medicaid** - Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under a reimbursement methodology based on historical cost. Retroactive settlements are not carried out by the Medicaid program.

**Blue Cross** - Services rendered to Blue Cross subscribers are reimbursed under a prospectively determined methodology.

**Nursing Home** - The Organization is reimbursed for resident services at established billing rates which are determined based on historical costs adjusted annually for inflation and subject to certain limitations as prescribed by South Dakota Department of Social Services regulations. These rates are subject to retroactive adjustment by field audit. The Organization also participates in the Medicare program for which payment for resident services is made on a prospectively determined per diem rate which varies based on a case-mix resident classification system.

The Organization has also entered into payments with certain commercial insurance carriers and other organizations. The basis for payment to the Organization under these agreements includes prospectively determined rates per discharge and discounts from established charges.

Concentration of gross revenues by major payor accounted for the following percentages of the Organization's patient and resident service revenues for the years ended December 31, 2016 and 2015:

	2016	2015
Medicare	42%	41%
Medicaid	7%	7%
Blue Cross	24%	25%
Other third-party payors, patients, and residents	27%	27%
	100%	100%

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net patient and resident service revenue for the years ended December 31, 2016 and 2015 increased by approximately \$691,000 and \$248,000, respectively, due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer likely subject to audits, reviews, and investigations.

### Note 3 - Deposits, Investments, and Investment Income

The carrying amounts of deposits and investments as of December 31, 2016 and 2015 are included in the Organization's statements of net position as follows:

	2016	2015
Carrying amount		
Cash and deposits	\$ 22,325,685	\$ 21,343,197
Investments	1,994,410	8,954,320
	\$ 24,320,095	\$ 30,297,517
Included in the following statement of net position captions		
Cash and cash equivalents	\$ 22,192,151	\$ 15,807,290
Noncurrent cash and investments - cash held in trust for debt service	133,534	133,534
Noncurrent cash and investments - Designated by Board	-	9,368,043
Noncurrent cash and investments - Other long-term investments	1,994,410	4,988,650
	\$ 24,320,095	\$ 30,297,517

### Deposits – Custodial Credit Risk

South Dakota statutes require that all municipal deposits are made in qualified public depositories, and that these depositories maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100 percent of the public deposit accounts which exceed deposit insurance such as FDIC and NCUA. As of December 31, 2016, all of the Organization's deposits were secured in accordance with these provisions.

## Investments

The Organization's investments are reported at fair value, as discussed in Note 1. At December 31, 2016 and 2015, the Organization had the following investments and maturities, all of which were held in the name of the City of Brookings by a custodial bank that is an agent of the City and the Organization:

	Carrying Amount	Investment in Maturities (in Years)			
		Less Than 1	1 - 5	6-10	10 +
December 31, 2016					
Federal Home Loan Bank	\$ 997,410	\$ -	\$ 997,410	\$ -	\$ -
Federal Farm Credit Bank	997,000	-	997,000	-	-
	<u>\$ 1,994,410</u>	<u>\$ -</u>	<u>\$ 1,994,410</u>	<u>\$ -</u>	<u>\$ -</u>
December 31, 2015					
Federal Home Loan Bank	\$ 992,670	\$ -	\$ 992,670	\$ -	\$ -
Federal Farm Credit Bank	2,991,350	-	2,991,350	-	-
Fed. Home Loan Mortgage Corp	2,990,730	-	2,990,730	-	-
U.S. Treasury Notes	1,979,570	-	1,979,570	-	-
	<u>\$ 8,954,320</u>	<u>\$ -</u>	<u>\$ 8,954,320</u>	<u>\$ -</u>	<u>\$ -</u>

## Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Organization does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

## Credit Risk

Investments - In general, SDCL 4-5-6 permits municipal funds to be invested in (a) securities of the United States and securities guaranteed by the United States government either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a); or in shares of an open-end, no load fund administered by an investment company whose investments are in securities described in (a) and repurchase agreements described in (b). As of December 31, 2016 and 2015, the Organization's investments in Federal Home Loan Bank, Federal Farm Credit Bank, Federal Home Loan Mortgage Corporation, and U.S. Treasury Notes were rated AA+ by Standard and Poor's and Aaa by Moody's Investor Services.

## Concentration of Credit Risk

The Organization places no limit on the amount it may invest in any one issuer.

## Fair Value Measurements

The Organization has determined the fair value of certain investments in accordance with generally accepted accounting principles, which provides a framework for measuring fair value. A hierarchy of valuation classifications considers whether the inputs used in valuation techniques are observable or unobservable. Valuation techniques should maximize the use of observable inputs and minimize the use of unobservable inputs.

The fair value hierarchy prioritizes the valuation inputs into the following three broad levels:

Level 1 – Unadjusted quoted prices for identical instruments in active markets that the reporting entity has the ability to access at the measurement date.

Level 2 – Quoted prices for similar investments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are directly or indirectly observable. Examples would be matrix pricing, market corroborated pricing and inputs such as yield curves and indices.

Level 3 – Valuations derived from valuation techniques in which significant inputs or significant value drivers are unobservable and may rely on the reporting entity’s own assumptions, but the market participant’s assumptions may be used in pricing the asset.

Inputs used to measure fair value might fall in different levels of the fair value hierarchy, in which case the Organization defaults to the lowest level input that is significant to the fair value measurement in its entirety. These levels are not necessarily an indication of the risk or liquidity associated with the investments. In determining the appropriate levels, the Organization performs an analysis of the assets that are subject to fair value measurement. The following table presents fair value measurements as of December 31, 2016 and 2015:

	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016				
Federal Home Loan Bank	\$ 997,410	\$ -	\$ 997,410	\$ -
Federal Farm Credit Bank	997,000	-	997,000	-
	<u>\$ 1,994,410</u>	<u>\$ -</u>	<u>\$ 1,994,410</u>	<u>\$ -</u>
December 31, 2015				
Federal Home Loan Bank	\$ 992,670	\$ -	\$ 992,670	\$ -
Federal Farm Credit Bank	2,991,350	-	2,991,350	-
Federal Home Loan Mortgage Corp	2,990,730	-	2,990,730	-
U.S. Treasury Notes	1,979,570	-	1,979,570	-
	<u>\$ 8,954,320</u>	<u>\$ -</u>	<u>\$ 8,954,320</u>	<u>\$ -</u>

### Investment Income

Investment income consists of the following for the years ended December 31, 2016 and 2015:

	2016	2015
Interest and dividend income	\$ 89,288	\$ 169,357
Realized gains, net	2,920	7,180
Net unrealized gain on investments	30,020	109,284
Investment income	\$ 122,228	\$ 285,821

### Note 4 - Investment in Joint Venture

Based on the Organization's ownership percentage, the joint venture investment and allocated earnings for the years ended December 31, 2016 and 2015 are as follows:

	2016		2015	
	Investment	Share of Income	Investment	Share of Income
Avera Home Medical Equipment of Brookings, LLC	\$ 218,279	\$ 148,779	\$ 236,820	\$ 91,051

The Hospital received distributions of \$167,321 and \$-0- from these investments in 2016 and 2015.

### Note 5 - Capital Assets

A summary of capital assets at December 31, 2016 and 2015, are as follows:

	December 31, 2015	Additions	Retirements/ Transfers	December 31, 2016
Land	\$ 1,617,996	\$ -	\$ -	\$ 1,617,996
Land improvements	2,301,707	5,637	-	2,307,344
Buildings	37,653,668	6,921,743	-	44,575,411
Equipment	23,503,983	1,036,265	-	24,540,248
Intangible assets	152,000	-	152,000	-
Construction in progress	4,821,303	30,289,824	7,031,791	28,079,336
Total at historical cost	70,050,657	38,253,469	7,183,791	101,120,335
Less accumulated depreciation for				
Land improvements	1,297,112	118,530	-	1,415,642
Buildings	17,108,208	1,530,927	-	18,639,135
Equipment	17,558,954	1,773,750	-	19,332,704
Intangible assets	152,000	-	152,000	-
Total accumulated depreciation	36,116,274	3,423,207	152,000	39,387,481
Capital assets, net	\$ 33,934,383	\$ 34,830,262	\$ 7,031,791	\$ 61,732,854

**Brookings Health System**  
Notes to Financial Statements  
December 31, 2016 and 2015

	December 31, 2014	Additions	Retirements/ Transfers	December 31, 2015
Land	\$ 1,617,996	\$ -	\$ -	\$ 1,617,996
Land improvements	2,301,707	-	-	2,301,707
Buildings	37,712,063	2,557	60,952	37,653,668
Equipment	23,094,283	1,048,253	638,553	23,503,983
Intangible assets	152,000	-	-	152,000
Construction in progress	85,117	4,736,186	-	4,821,303
Total at historical cost	<u>64,963,166</u>	<u>5,786,996</u>	<u>699,505</u>	<u>70,050,657</u>
Less accumulated depreciation for				
Land improvements	1,173,074	124,038	-	1,297,112
Buildings	15,706,348	1,462,812	60,952	17,108,208
Equipment	16,286,111	1,854,499	581,656	17,558,954
Intangible assets	152,000	-	-	152,000
Total accumulated depreciation	<u>33,317,533</u>	<u>3,441,349</u>	<u>642,608</u>	<u>36,116,274</u>
Capital assets, net	<u>\$ 31,645,633</u>	<u>\$ 2,345,647</u>	<u>\$ 56,897</u>	<u>\$ 33,934,383</u>

Construction in progress at December 31, 2016 and 2015, represents costs incurred for the construction of the Organization's new hospital addition, renovation of the existing hospital and construction of a medical office building, including the furnishings and equipment of these facilities. The estimated cost to complete this project is approximately \$45,000,000, with construction and engineering commitments of approximately \$11,500,000 as of December 31, 2016, a portion of which will be financed with the proceeds from the 2015B certificates of participation (see note 7).

**Note 6 - Leases**

The Organization leases clinic office space and equipment under certain non-cancellable and cancellable long-term lease agreements. Total lease expense for the years ended December 31, 2016 and 2015, for all operating leases was \$863,882 and \$901,336, respectively. Minimum future lease payments for the operating leases are \$118,143 in 2017.

**Note 7 - Long Term Debt**

A schedule of changes in the Hospital's long-term debt for 2016 and 2015 is as follows:

	Balance December 31, 2015	Additions	Reductions	Balance December 31, 2016	Amounts due within one year
Series 2012 - Certificates of Participation	\$ 9,509,843	\$ -	\$ (222,098)	\$ 9,287,745	\$ 229,540
Series 2015A - Certificates of Participation	79,400	7,920,600	-	8,000,000	218,137
Series 2015B - Certificates of Participation	200,600	4,288,579	-	4,489,179	240,889
	<u>\$ 9,789,843</u>	<u>\$ 12,209,179</u>	<u>\$ (222,098)</u>	<u>\$ 21,776,924</u>	<u>\$ 688,566</u>
	Balance December 31, 2014	Additions	Reductions	Balance December 31, 2015	Amounts due within one year
Series 2012 - Certificates of Participation	\$ 9,724,739	\$ -	\$ (214,896)	\$ 9,509,843	\$ 222,098
Series 2015A - Certificates of Participation	-	79,400	-	79,400	-
Series 2015B - Certificates of Participation	-	200,600	-	200,600	-
	<u>\$ 9,724,739</u>	<u>\$ 280,000</u>	<u>\$ (214,896)</u>	<u>\$ 9,789,843</u>	<u>\$ 222,098</u>

Long-term debt maturities are as follows:

Year Ending December 31,	Principal	Interest	Total
2017	\$ 688,566	\$ 594,651	\$ 1,283,217
2018	2,111,631	643,930	2,755,561
2019	2,182,456	573,105	2,755,561
2020	2,255,745	499,816	2,755,561
2021	2,236,157	519,404	2,755,561
2022 to 2026	5,689,026	1,639,963	7,328,989
2027 to 2031	1,706,450	964,228	2,670,678
2032 to 2036	2,012,211	658,466	2,670,677
2037 to 2041	2,372,758	297,919	2,670,677
2042	521,924	10,825	532,749
Total	<u>\$ 21,776,924</u>	<u>\$ 6,402,307</u>	<u>\$ 28,179,231</u>



Certificates of Participation relate to debt issued by the City of Brookings to facilitate the financing of public capital projects.

In October 2012, the City of Brookings issued \$10,000,000 in Series 2012 certificates of participation, which was subsequently refinanced in July 2013 to gain a lower interest rate, to fund the construction of the Organization's skilled nursing facility. The certificates bear interest at 3.31% and are due in quarterly installments through October 2042. The City leases the assets acquired with the proceeds from the certificates of participation under a Master Lease Purchase Agreement. For financial reporting purposes, the Organization accounts for the 2012 certificates of participation as its own debt.

During the year ended December 31, 2015, the City of Brookings issued \$8,000,000 in Series 2015A certificates of participation and \$22,000,000 in Series 2015B certificates of participation, to fund the in-progress construction of the Organization's new hospital addition, renovation of the existing hospital and construction of a medical office building, including the furnishings and equipment of these facilities. The 2015A certificates bear interest fixed at 2.60% and requires quarterly interest payments through July 2017, at which time the Organization will begin making quarterly installments, including principal and interest, of \$270,137, through October 2020. In October 2020, the interest rate associated with the 2015A certificates will adjust to a variable interest rate equal to the lesser of (a) WSJ Prime minus 0.65% or (b) 4.60%, with quarterly installments, including principal and interest, of \$284,145 through October 2025. The 2015B certificates bear interest fixed at 3.95% and requires quarterly interest payment through July 2017, at which time the Organization will begin making quarterly installments, including principal and interest, of \$285,219, through October 2020, at which time the quarterly installments will decrease to \$271,211 through October 2025. In October 2025, the interest rate associated with the 2015B certificates will adjust to a variable interest rate equal to the lesser of (a) WSJ Prime plus 0.70% or (b) 4.95%, with quarterly installments, including principal and interest, of \$555,356 through October 2030. In October 2030, the interest rate associated with the 2015B certificates will adjust to a variable interest rate equal to the lesser of (a) WSJ Prime plus 0.70% or (b) 5.95%, with quarterly installments, including principal and interest, remaining consistent through October 2037.

The City leases the assets acquired with the proceeds from the certificates of participation under a Master Lease Purchase Agreement. For financial reporting purposes, the Organization accounts for the 2015A and 2015B certificates of participation as its own debt.

## **Note 8 - Pension Plan**

### *Plan Description*

Eligible employees participate in the South Dakota Retirement System (SDRS), a cost-sharing, multiple employer public employer defined benefit pension plan administered by SDRS to provide retirement benefits for employees of the State of South Dakota and its political subdivisions. The SDRS provides retirement, disability, and survivor's benefits. The right to receive retirement benefits vests after three years of credited service. Authority for establishing, administering and amending plan provisions are found in South Dakota Codified Law 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained at <http://www.sdrs.sd.gov/publications/> or by writing to SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

### *Benefits Provided*

SDRS has three different classes of employees, Class A, Class B public safety and Class B judicial. Class A retirement benefits are determined as 1.7% prior to 2008 and 1.55% thereafter of the employee's final 3-year average compensation times the employee's years of service. Employees with 3 years of service are eligible to retire at age 55. Class B public safety benefits are determined as 2.4% for service prior to 2008 and 2.0% thereafter of employee final average compensation. Class B judicial benefits are determined as 3.733% or service prior to 2008 and 3.333% thereafter of employee final average compensation. All Class B employees with 3 years of service are eligible to retire at age 45. Employees are eligible for service-related disability benefits regardless of length of service. Three years of service is required for nonservice-related disability eligibility. Disability benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction. Death benefits are a percentage of the employee's final average salary.

The annual increase in the amount of the SDRS benefits payable each July 1st is indexed to the consumer price index (CPI) based on SDRS funded status:

- If the SDRS market value funded ratio is 100% or more -- 3.1% COLA
- If the SDRS market value funded ratio is 80% to 99.9%, indexed with the CPI
  - 90.0% to 99.9% funded -- 2.1% minimum and 2.8% maximum COLA
  - 80.0% to 90.0% funded -- 2.1% minimum and 2.4% maximum COLA
- If the SDRS market value funded ratio is less than 80% -- 2.1% COLA

All benefits except those depending on the Member's Accumulated Contributions are annually increased by the Cost-of-Living Adjustment.

### *Contributions*

Per SDCL 3-12, contribution requirements of the active employees and the participating employers are established and may be amended by the SDRS Board. Covered employees are required by state statute to contribute the following percentages of their salary to the plan; Class A Members, 6.0% of salary, Class B Judicial Members, 9.0% of salary; and Class B Public Safety Members, 8.0% of salary. State statute also requires the employer to contribute an amount equal to the employee's contribution. State statute also requires the employer to make an additional contribution in the amount of 6.2 percent for any compensation exceeding the maximum taxable amount for social security for general employees only. The Organization's share of contributions to the SDRS for the years ending December 31, 2016, 2015 and 2014, equal to required contributions each year, were \$1,004,894, \$1,009,830 and \$985,828, respectively.

*Pension (Liabilities) Assets, Pension Expense (Revenue), and Deferred Outflows of Resources and Deferred Inflows of Resources to Pensions*

At June 30, 2016 and 2015, SDRS is 97% and 104%, respectively, funded and accordingly has a net pension liability and asset, respectively. The proportionate shares of the components of the net pension (liability) asset of SDRS, for the Organization as of December 31, 2016 and 2015 are as follows:

	2016	2015
Proportionate share of net position restricted for pension benefits	\$ 95,347,915	\$ 98,359,575
Less proportionate share of total pension liability	98,411,377	94,488,469
Proportionate share of net pension (liability) asset	\$ (3,063,462)	\$ 3,871,106

The net pension (liability) asset was measured as of June 30, 2016 and June 30, 2015 and the total pension liability used to calculate the net pension (liability) asset was determined by actuarial valuation as of those dates. At December 31, 2016, the Organization reported a liability of (\$3,063,462) and at December 31, 2015 an asset of \$3,871,106 for its proportionate share of the net pension (liability) asset. The total pension (liabilities) assets used to calculate the net pension (liabilities) assets were based on a projection of the Organization's share of contributions to the pension plan relative to the contributions of all participating entities. At June 30, 2016 and 2015, the Organization's proportion was 0.9069126% and 0.9127200%, respectively.

For the years ended December 31, 2016 and 2015, the Organization recognized pension expense of \$2,249,556 and \$431,621, respectively.

At December 31, 2016 the Organization reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 1,066,460	\$ -
Changes in assumption	1,834,868	-
Net difference between projected and actual earnings on pension plan investments	3,407,605	-
Changes in proportion and difference between Organization contributions and proportionate share of contributions	61,245	-
Organization contributions subsequent to measurement date	494,690	-
Total	\$ 6,864,868	\$ -

At December 31, 2016, there is \$494,690 reported as deferred outflows of resources related to pensions resulting from Organization contributions subsequent to the June 30, 2016 measurement date that will be recognized as a reduction of the net pension liability during the year ending December 31, 2017.

Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in net pension expense as follows:

Year Ended December 31,

2017		\$ 1,725,001
2018		1,052,400
2019		2,171,228
2020		<u>1,421,549</u>
Total		<u>\$ 6,370,178</u>

At December 31, 2015, the Organization reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 792,627	\$ -
Changes in assumption	3,069,544	-
Net difference between projected and actual earnings on pension plan investments	-	3,347,098
Changes in proportion and difference between Organization contributions and proportionate share of contributions	55,984	-
Organization contributions subsequent to measurement date	<u>524,494</u>	<u>-</u>
Total	<u>\$ 4,442,649</u>	<u>\$ 3,347,098</u>

At December 31, 2015, there was \$524,494 reported as deferred outflows of resources related to pensions resulting from Organization contributions subsequent to the June 30, 2015 measurement date that was recognized as an decrease of the net pension liability during the year ending December 31, 2016.

*Actuarial Assumptions*

The total pension liability in the SDRS June 30, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%
Salary increases	5.83% at entry to 3.87% after 30 years of service
Investment rate of return	7.25% through 2017 and 7.5% thereafter, net of pension plan investment expense
Mortality rates	RP-2000 Employee Mortality Table for males and females

The actuarial assumptions used in the SDRS June 30, 2016 valuation were based on the results of an actuarial experience study for the period July 1, 2005 through June 30, 2011. The mortality assumptions were revised based on an extension of the experience study including mortality experience through June 30, 2013.

Investment portfolio management is the statutory responsibility of the South Dakota Investment Council (SDIC), which may utilize the services of external money managers for management of a portion of the portfolio. SDIC is governed by the Prudent Man Rule (i.e., the council should use the same degree of care as a prudent man). Current SDIC investment policies dictate limits on the percentage of assets invested in various types of vehicles (equities, fixed income securities, real estate, cash, private equity, etc.). The long-term expected rate of return on pension plan investments was determined using a method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

Best estimates of real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2016 (see the discussion of the pension plan's investment policy) are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Global Equity	58.0%	4.8%
Fixed Income	30.0%	1.8%
Real Estate	10.0%	4.6%
Cash	2.0%	0.7%
Total	100.0%	

*Discount Rate*

The discount rate used to measure the total pension (liability) asset was 7.25% through 2017 and 7.50% thereafter. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that matching employer contributions from will be made at rates equal to the member rate. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension (liability) asset.

*Sensitivity of the Employer's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate*

The following presents the Organization's proportionate share of net pension (liability) asset as of June 30, 2016 calculated using the discount rate of 7.25% through 2017 and 7.50% thereafter, as well as what the Organization's proportionate share of the net pension (liability) asset would be if it were calculated using a discount rate that is one percentage point lower (6.25/6.50%) or one percentage point higher (8.25/8.50%) than the current rate:

	1% Decrease	Current Discount Rate	1% Increase
Organization's proportionate share of the net pension (liability) asset	\$ (17,143,091)	\$ (3,063,462)	\$ 8,419,988

*Pension Plan Fiduciary Net Position*

Detailed information about the plan's fiduciary net position is available in the separately issued SDRS financial report.

**Note 9 - Post-Employment Benefits**

The Organization has adopted GASB Codification Section P50, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions*. The Organization engaged an actuary to determine the Organization's liability for post-employment health care benefits other than pensions and the actuary determined the only obligation the Organization has to record is the implied subsidy portion as described in the standard.

*Plan Description* – All employees of the Organization are allowed upon meeting the eligibility requirements, to participate in the Organization's health insurance plan after retirement. This plan covers active and retired employees. The benefit provisions for employees represented by a collective bargaining agreement are established and amended through collective bargaining with the recognized bargaining agent for each group. Benefits and eligibility for administrators, and those not covered by a collective bargaining agreement, are established and amended by the governing body. The Organization's plan is a self-funded plan reported as an internal service fund of the City of Brookings.

*Plan Administration and Reporting* – Brookings Health System administers the plan through an internal service fund of the City of Brookings. No separate financial reporting is done by the plan.

*Authority for Establishment of Benefit Provisions* – Under the authority of SDCL 6-1-16, Brookings Health System, through the Authority of the City Of Brookings as a South Dakota municipality, may provide for health insurance for retiring employees as the governing body deems appropriate subject to the limitations as described in SDCL 9-14-35.

*Obligations of Plan Members and Sponsoring Organization* – The governing board of the Organization determines the contribution amounts for the plan, which currently requires participating members to pay 100% of the group rate premium. Future amendments to the funding mechanism of the benefit plan are determined by the governing board.

*Funding Policy* – The Organization has elected to fund the plan on a pay-as-you-go method.

*Annual OPEB Cost and Net OPEB Obligation* – The Organization's annual other post-employment benefit (OPEB) expense is calculated based on the annual required contribution of the Organization, an amount actuarially determined in accordance with the parameters of GASB Codification Section P50. The annual required contribution represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period of thirty years.

The following table shows the components of the Organization's annual OPEB cost for the year, the amount actually contributed to the plan, and the changes in the Organization's net OPEB obligation:

	December 31, 2016	December 31, 2015
Annual required contribution	\$ 108,385	\$ 102,033
Interest on net OPEB obligation	14,057	11,969
Adjustment to annual required contribution	(16,661)	(14,186)
Annual OPEB cost	105,781	99,816
Contributions made	(36,181)	(30,216)
Increase in OPEB obligation	69,600	69,600
Net OPEB obligation, beginning of year	468,575	398,975
Net OPEB obligation, end of year	\$ 538,175	\$ 468,575

The Organization's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the previous three fiscal periods are summarized as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/2016	\$ 105,781	34.20%	\$ 538,175
12/31/2015	\$ 99,816	30.27%	\$ 468,575
12/31/2014	\$ 100,211	29.15%	\$ 398,975

*Funded Status and Funding Progress* – As of January 1, 2016, the most recent actuarial valuation date, the plan was unfunded. The actuarial accrued liability for benefits was \$1,116,774, and the actuarial value of assets was \$-0- resulting in an unfunded actuarial accrued liability (UAAL) of \$1,116,774. As noted above, unfunded actuarial liabilities are being amortized over a period of thirty years.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to the continual revision as actual results are compared with past expectations and new estimates are made about the future.

The Organization's schedule of funding progress, which presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits, is included in the required supplementary information (RSI).

*Actuarial Methods and Assumptions* – Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2016 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 3.00 percent investment rate of return (net of administrative expense), which is a blended rate of the expected long-term investment returns on the employer’s own investments, and an annual healthcare cost trend rate of 5.10 percent initially, reduced to an ultimate rate of 4.10 percent over the study period, with annual rates ranging from 4.20 to 9.00 percent. Both rates include an inflation assumption. The UAAL is being amortized as a level percentage of projected payroll on an open basis over 30 years.

**Note 10 - Concentration of Credit Risk**

The Organization grants credit without collateral to its patients and residents, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors, patients, and residents at December 31, 2016 and 2015, was as follows:

	2016	2015
Medicare	35%	35%
Medicaid	6%	6%
Blue Cross	14%	20%
Dakotacare	5%	7%
Commercial	7%	7%
Other third-party payors, patients, and residents	33%	25%
	100%	100%

**Note 11 - Related Party Transactions**

As discussed in Note 1, the Organization is an enterprise fund of the City of Brookings, South Dakota. The Organization purchased services, equipment, supplies, and insurance from the City of Brookings for the year ended December 31, 2016 and 2015 of \$730,297 and \$603,261, respectively. As of December 31, 2016 and 2015, accounts payable to related parties was \$46,098 and \$31,238, respectively.

The Foundation contracts for the services of its development director and certain other operational costs from the Organization. During the years ended December 31, 2016 and 2015, the Organization forgave costs incurred of \$74,968 and \$228,215, respectively. These amounts are included in nonoperating expenses, as Foundation transfers and other, for the years ended December 31, 2016 and 2015.

The Organization has an agreement with Avera Home Medical Equipment of Brookings, LLC for the lease of office space. Brookings Health System received rent revenue of \$42,600 for the years ended December 31, 2016 and 2015.



## **Note 12 - Commitments and Contingencies**

### **Malpractice Insurance**

The Organization has malpractice insurance coverage to provide protection for professional liability losses on a claims-made basis subject to a limit of \$1 million per claim and an annual aggregate limit of \$3 million. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, would be uninsured. The Organization is also insured under an occurrence based excess umbrella policy with a limit of \$3 million.

### **Unemployment Benefits**

The Organization provides coverage for unemployment benefits by paying into the Unemployment Compensation Fund established by state law and managed by the State of South Dakota.

### **Litigations, Claims, and Disputes**

The Organization is subject to the usual contingencies in the normal course of operations relating to the performance of its tasks under its various programs. In the opinion of management, the ultimate settlement of litigation, claims, and disputes in process will not be material to the financial position of the Organization.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient services. Management believes that the Organization is in substantial compliance with current laws and regulations.

### **Other Insurance**

The Organization purchases liability insurance for workers' compensation from a commercial carrier.

The Organization insures the healthcare benefits of its employees under an indemnity plan.

### **Professional Service Agreement Commitments**

The Organization contracts with a third party for various services in the operation of its provider-based clinic operations in Brookings, South Dakota. The Organization entered into a three year agreement for professional services. Under the agreement, the Organization pays compensation for physician services contingent on the amount of services provided at an agreed upon rate which is annually reviewed and adjusted by the parties based on various factors. Additionally, under the agreement, the Organization is required to pay approximately \$7 million annually for other non-physician services provided. However, at any time, the agreement is cancellable upon ninety days' notice.

**Note 13 - Disclosures Regarding Brookings Health System Foundation**

**Significant Accounting Policies**

**Contributions and Promises to Give**

Contributions received and pledge receivables are recorded as unrestricted, temporarily restricted or permanently restricted depending on the existence or nature of any donor-imposed restrictions.

Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are transferred to unrestricted net assets in the statement of activities.

Unconditional promises to give expected to be collected within one year are recorded at net realizable value. Unconditional promises to give expected to be collected in future years are initially recorded at fair value using present value techniques incorporating risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the asset. In subsequent years, amortization of the discounts is included in contribution revenue in the statement of activities. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

Contributions receivable as of December 31, 2016 and 2015 represent unconditional promises to give. Contributions receivable are reflected at fair value based on estimated discounted future cash flows, currently using an 8% discount rate factor. Maturities are as follows:

	2016	2015
Receivable in less than one year	\$ 406,643	\$ 1,627,491
Receivable in one to five years	1,108,975	1,109,375
Receivable in periods beyond five years	700,149	1,030,932
Total contributions receivable	2,215,767	3,767,798
Less discount to net present value	(595,590)	(706,629)
Net contributions receivable	\$ 1,620,177	\$ 3,061,169

Management determines the allowance for uncollectable promises to give based on historical experience, an assessment of economic conditions, and a review of subsequent collections. Promises to give are written off when deemed uncollectable. At December 31, 2016 and 2015, management determined that no allowance was considered necessary.

**Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the Foundation has been limited by donors for a specific time period or purpose. The Foundation's statement of activities includes the changes in those temporarily restricted net assets. Temporarily restricted net assets at December 31, 2016 and 2015 consisted of:

	2016	2015
Restricted by donors for		
Contributions receivable for capital projects	\$ 1,556,177	\$ 3,061,169
Capital Campaign	425,835	712,557
Brookings Health System Hospice	112,323	108,209
Brookings Health System Tough Enough	26,107	27,472
Other	129,278	45,891
	\$ 2,249,720	\$ 3,955,298

Permanently restricted net assets have been restricted by donors to be maintained by the Foundation in perpetuity. At December 31, 2016 and 2015, the Organization did not have any permanently restricted net assets.

**Income Taxes**

The Foundation is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. The Foundation is annually required to file a Return of Organization Exempt from Income Tax (Form 990) with the IRS. The Foundation believes they have appropriate support for any tax positions taken affecting their annual filing requirements, and as such, do not have any uncertain tax positions that are material to the financial statements. The Foundation would recognize future accrued interest and penalties related to unrecognized tax benefits and liabilities in income tax expense if such interest and penalties are incurred.



Required Supplementary Information  
December 31, 2016 and 2015

# Brookings Health System

**Brookings Health System**  
 Schedule of Funding Progress for the Retiree Health Plan  
 Years Ended December 31, 2008 - 2016

Year Ended December 31,	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (Unit Credit Cost Method) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
2008	January 1, 2008	\$ -	\$ 627,105	\$ 627,105	0.0%	\$ 12,467,890	5%
2009	January 1, 2008	-	627,105	627,105	0.0%	12,467,890	5%
2010	January 1, 2010	-	468,328	468,328	0.0%	13,711,402	3%
2011	January 1, 2010	-	468,328	468,328	0.0%	13,711,402	3%
2012	January 1, 2012	-	1,088,282	1,088,282	0.0%	13,501,040	8%
2013	January 1, 2012	-	1,088,282	1,088,282	0.0%	13,501,040	8%
2014	January 1, 2014	-	1,086,409	1,086,409	0.0%	15,845,473	7%
2015	January 1, 2014	-	1,086,409	1,086,409	0.0%	15,845,473	7%
2016	January 1, 2016	-	1,116,774	1,116,774	0.0%	16,764,400	7%

See Note 9 in the accompanying Notes to Financial Statements for the plan description, funding policy, annual OPEB cost, net OPEB obligation, funded status, and funding progress.

Brookings Health System  
Schedule of Pension Contributions  
December 31, 2016

**South Dakota Retirement System  
Last 10 Years \*\***

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Contractually required contribution	\$ 1,004,894	\$ 1,009,830	\$ 985,828	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Contributions in relation to the contractually required contribution	<u>1,004,894</u>	<u>1,009,830</u>	<u>985,828</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Organization's covered employee payroll	\$ 16,764,400	\$ 16,184,795	\$ 15,845,473	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Contributions as a percentage of covered employee payroll	6.0%	6.2%	6.2%							

\*\* This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10 year trend is compiled, the Organization will present information for those years for which information is available. Data reported is measured as of the calendar year end.

Brookings Health System  
Schedule of Proportionate Share of Net Pension Liability (Asset)  
December 31, 2016

**South Dakota Retirement System  
Last 10 Years \*\***

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Organization's proportion of the net pension liability (asset)	0.9069126%	0.9127200%	0.9300359%	%	%	%	%	%	%	%
Organization's proportionate share of net pension liability (asset)	\$ 3,063,462	\$ (3,871,106)	\$ (6,700,528)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Organization's covered employee payroll	\$ 16,590,274	\$ 16,080,795	\$ 16,263,771	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Organization's proportionate share of the net pension liability (asset) as a percentage of its covered employee payroll	18.5%	24.1%	41.2%							
Plan fiduciary net position as a percentage of the total pension liability (asset)	97%	104%	107%							

NOTE: The amounts presented for each year were determined as of 06/30

\*\* This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10 year trend is compiled, the Organization will present information for those years for which information is available. Data reported is measured as of the measurement date.



**Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance  
and Other Matters Based on an Audit of Financial Statements Performed in Accordance with  
*Government Auditing Standards***

The Board of Directors  
Brookings Health System  
Brookings, South Dakota

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Brookings Health System, which comprise the statement of net position as of December 31, 2016, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 6, 2017.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Brookings Health System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Brookings Health System’s internal control. Accordingly, we do not express an opinion on the effectiveness of Brookings Health System’s internal control.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not yet been identified. We did identify a deficiency in internal control, described in the accompanying Schedule of Findings and Responses as Finding 2016-1 that we consider to be a significant deficiency.



**Compliance and Other Matters**

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

**Brookings Health System's Response to Findings**

Brookings Health System's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. Brookings Health System's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. As required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



Sioux Falls, South Dakota  
April 6, 2017

**Finding No. 2016-1 – Preparation of Financial Statements and Pension-related Reporting**

Criteria: An effective system of internal control contemplates the ability on the part of management to prepare complete financial statements which includes all footnote disclosures in accordance with general accepted accounting principles.

Condition: The Organization does not have an internal control system designed to provide for the preparation of the full disclosure financial statements in accordance with accounting standards generally accepted in the United States of America. As auditors, we proposed significant audit adjustments to and prepared significant disclosures for the financial statements, related to the pension-related reporting. Additionally, as part of the preparation of pension-related disclosures, we experienced difficulties obtaining the necessary pension-related payroll information. These entries and disclosures would not have been identified as a result of the Organization's existing internal controls, and therefore resulted in misstatements. We were also requested to draft the financial statements and accompanying notes to the financial statements.

Cause: The Organization has limited staff to prepare full disclosure financial statements. The payroll department doesn't appear to have a comprehensive understanding of the necessary pension-related payroll reporting, which is a key factor in the reporting and allocation of pension-related activity. Management has elected to have the financial statements and footnotes prepared by the external audit firm as part of the audit.

Effect: Pension-related audit adjustments were recorded to the December 31, 2016 financial statements. The inability to prepare the financial statements in accordance with accounting standards generally accepted in the United States of America, may affect the ability to properly report the Organization's financial position and results of operations.

Recommendation: While we recognize that this condition is not unusual for an organization with limited staffing, it is important that the Organization is aware of this condition for financial reporting purposes. Management and the board of directors should continually be aware of the financial accounting and reporting of the Organization and changes in the accounting and reporting requirements.

Response: Management will review the year-end adjustments and pension-related disclosure information. Management and the board of directors will review for propriety the draft financial statements and footnotes. Due to the Organization's limited staffing, we will accept the risk associated with financial statement preparation, based on cost and other considerations, and will review existing resources for necessary improvements to the pension-related payroll reporting. The cost of any further controls would outweigh the related benefits.