



Financial Statements
December 31, 2016 and 2015

Community Memorial Hospital

Community Memorial Hospital

Table of Contents

December 31, 2016 and 2015

| | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|
| Independent Auditor’s Report..... | 1 |
| Financial Statements | |
| Statements of Net Position..... | 3 |
| Statements of Revenues, Expenses and Changes in Net Position..... | 4 |
| Statements of Cash Flows..... | 5 |
| Notes to Financial Statements..... | 7 |
| Required Supplemental Information | |
| Schedule of Pension Contributions..... | 25 |
| Schedule of Proportionate Share of Net Pension Liability (Asset)..... | 26 |
| 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 <i>Government Auditing Standards</i> | 27 |
| Schedule of Findings and Responses..... | 29 |



Independent Auditor's Report

The Board of Governors
Community Memorial Hospital
Redfield, 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 Community Memorial Hospital (Hospital), an enterprise fund of the City of Redfield, South Dakota as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Hospital'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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of Community Memorial Hospital, an enterprise fund of the City of Redfield, South Dakota, as of December 31, 2016 and 2015, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Enterprise Fund Financial Statements

As discussed in Note 1, the financial statements present only Community Memorial Hospital, an enterprise fund of the City of Redfield, South Dakota, and do not purport to, and do not, present fairly the financial position of the City of Redfield, South Dakota, the changes in its financial position, or where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is 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 Schedules of Pension Contributions, and Proportionate Share of Net Pension Liability (Asset) on pages 25 and 26 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.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America requires to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by the missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated April 24, 2017 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.



Sioux Falls, South Dakota
April 24, 2017

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| | 2016 | 2015 |
|----------------------------------------------------------------------------------------|----------------------|----------------------|
| Assets and Deferred Outflows of Resources | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 2,188,925 | \$ 1,078,065 |
| Short-term investments | 101,064 | 75,407 |
| Receivables | | |
| Patient, net of estimated uncollectibles of \$446,000 in 2016 and \$400,000 in 2015 | 2,025,147 | 1,580,239 |
| Estimated third-party payor settlements | - | 190,000 |
| Other | 28,788 | 32,651 |
| Supplies | 108,708 | 123,874 |
| Prepaid expenses | 7,096 | 84,900 |
| | <u>4,459,728</u> | <u>3,165,136</u> |
| Noncurrent Cash | | |
| Held by Trustee for debt service | <u>521,951</u> | <u>529,372</u> |
| Capital Assets | | |
| Non-depreciable capital assets | 5,000 | 5,000 |
| Depreciable capital assets, net | <u>6,760,000</u> | <u>6,791,161</u> |
| | <u>6,765,000</u> | <u>6,796,161</u> |
| Other Assets | | |
| Note receivable | 122,500 | 87,500 |
| Net pension asset | <u>-</u> | <u>1,184,017</u> |
| | <u>122,500</u> | <u>1,271,517</u> |
| | <u>11,869,179</u> | <u>11,762,186</u> |
| Deferred Outflows of Resources | | |
| Related to pension | <u>2,073,960</u> | <u>1,351,155</u> |
| | <u>\$ 13,943,139</u> | <u>\$ 13,113,341</u> |

See Notes to Financial Statements

Community Memorial Hospital
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 | \$ 310,677 | \$ 344,641 |
| Accounts payable | | |
| Trade | 457,914 | 162,592 |
| Estimated third-party payor settlements | 110,000 | - |
| Accrued expenses | | |
| Salaries and wages | 204,135 | 122,451 |
| Compensated absences | 300,059 | 299,065 |
| Payroll taxes and other | 30,966 | 34,478 |
| Accrued interest | 26,442 | 26,789 |
| Unearned revenue | 74,318 | 96,547 |
| | 1,514,511 | 1,086,563 |
| Long-term debt, less current maturities | 7,411,596 | 7,721,982 |
| Net pension liability | 904,820 | - |
| | 9,830,927 | 8,808,545 |
| Deferred Inflows of Resources | | |
| Related to pension | - | 1,023,744 |
| Net Position | | |
| Net investment in capital assets (Deficit) | (614,311) | (832,161) |
| Restricted, expendable for debt service | 521,951 | 529,372 |
| Restricted for pension benefits | 1,169,140 | 1,511,428 |
| Unrestricted | 3,035,432 | 2,072,413 |
| | 4,112,212 | 3,281,052 |
| | \$ 13,943,139 | \$ 13,113,341 |

Community Memorial Hospital
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|----------------------------------------------------------------------------------------------------------|---------------|---------------|
| Operating Revenues | | |
| Net patient service revenue (net of provision for bad debts of \$333,936 and \$427,707 in 2016 and 2015) | \$ 11,562,993 | \$ 10,470,034 |
| Other revenue | 594,490 | 452,602 |
| | 12,157,483 | 10,922,636 |
| Operating Expenses | | |
| Salaries and wages | 5,215,489 | 4,965,101 |
| Employee benefits | 1,974,007 | 1,409,771 |
| Purchased services | 1,581,793 | 1,166,042 |
| Supplies and other expense | 2,087,409 | 2,022,538 |
| Depreciation and amortization | 638,668 | 583,362 |
| | 11,497,366 | 10,146,814 |
| Operating Income | 660,117 | 775,822 |
| Nonoperating Revenues (Expenses) | | |
| Investment income | 941 | 566 |
| Non capital grants and contributions | 106,712 | 183,110 |
| Interest expense and financing costs | (333,710) | (564,031) |
| Debt issuance costs | - | (311,418) |
| | (226,057) | (691,773) |
| Revenues in Excess of Expenses | 434,060 | 84,049 |
| Grants and Contributions for Capital Assets | 397,100 | 712 |
| Increase in Net Position | 831,160 | 84,761 |
| Net Position, Beginning of Year | 3,281,052 | 3,196,291 |
| Net Position, End of Year | \$ 4,112,212 | \$ 3,281,052 |

Community Memorial Hospital
Statements of Cash Flows
Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|--------------------------------------------------------------------|---------------------|---------------------|
| Operating Activities | | |
| Received from and on behalf of patients | \$ 11,418,085 | \$ 10,258,087 |
| Payments to suppliers | (3,280,910) | (3,330,053) |
| Payments to and on behalf of employees | (6,803,042) | (6,551,591) |
| Other receipts and payments | 598,353 | 454,443 |
| | <u>1,932,486</u> | <u>830,886</u> |
| Net Cash from Operating Activities | | |
| Non-Capital Financing Activities | | |
| Noncapital grants and contributions | 84,484 | 184,729 |
| Change in line of credit | - | (450,000) |
| | <u>84,484</u> | <u>(265,271)</u> |
| Net Cash from (used for) Non-capital Financing Activities | | |
| Capital and Capital Related Financing Activities | | |
| Purchases of capital assets | (607,507) | (10,251) |
| Proceeds from issuance of long-term debt | - | 8,063,321 |
| Principal payments on long-term debt and debt extinguishment costs | (344,663) | (7,836,474) |
| Capital grants and contributions | 397,100 | 712 |
| Interest payments and debt issuance costs | (333,745) | (771,966) |
| | <u>(888,815)</u> | <u>(554,658)</u> |
| Net Cash used for Capital and Related Financing Activities | | |
| Investing Activities | | |
| Investment income | 941 | 566 |
| Purchases of short-term investments | (25,657) | (25,307) |
| | <u>(24,716)</u> | <u>(24,741)</u> |
| Net Cash used for Investing Activities | | |
| Increase (decrease) in Cash and Cash Equivalents | 1,103,439 | (13,784) |
| Cash and Cash Equivalents, Beginning of Year | <u>1,607,437</u> | <u>1,621,221</u> |
| Cash and Cash Equivalents, End of Year | <u>\$ 2,710,876</u> | <u>\$ 1,607,437</u> |
| Reconciliation of Cash and Cash Equivalents to the Balance Sheet | | |
| Cash in current assets | \$ 2,188,925 | \$ 1,078,065 |
| Non Current cash held by Trustee for debt service | 521,951 | 529,372 |
| | <u>\$ 2,710,876</u> | <u>\$ 1,607,437</u> |

Community Memorial Hospital
 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 | \$ 660,117 | \$ 775,822 |
| Adjustments to reconcile operating income to net cash from operating activities | | |
| Depreciation and amortization | 638,668 | 583,362 |
| Provision for bad debts | 333,936 | 427,707 |
| Change in assets and liabilities | | |
| Accounts receivable | (619,981) | (672,813) |
| Supplies | 15,166 | 4,261 |
| Prepaid expense | 77,804 | 1,934 |
| Accounts payable | 405,322 | (147,668) |
| Accrued expenses | 79,166 | 24,808 |
| Net pension asset/liability | 2,088,837 | 887,629 |
| Deferred outflows of resources | (722,805) | (401,881) |
| Deferred inflows of resources | (1,023,744) | (652,275) |
| Net Cash from Operating Activities | \$ 1,932,486 | \$ 830,886 |
| Amortization of bond discounts | \$ 313 | \$ 47,126 |

Note 1 - Reporting Entity and Summary of Significant Accounting Policies

The financial statements of Community Memorial Hospital (Hospital) 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 Hospital are described below.

Reporting Entity

The Hospital operates a 25-bed hospital and a medical clinic in Redfield, South Dakota. The Hospital is controlled by the city of Redfield, South Dakota and is accounted for as an enterprise fund of the City. These financial statements present only the financial activity of the Hospital. Financial statements of the City of Redfield, South Dakota, are prepared under separate cover.

For financial reporting purposes, the Hospital has included all funds, organizations, agencies, boards, commissions, and authorities. The Hospital has also 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 Hospital are such that the exclusion would cause the Hospital'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 Hospital 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 Hospital. The Hospital does not have a component unit which meets the GASB criteria.

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 the 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 Hospital's assets, deferred outflows, liabilities and deferred inflows 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.

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 Hospital.

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 Hospital'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, and 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 investments in highly liquid debt instruments with original maturities of three months or less.

Short-Term Investments

Short-term investments include certificates of deposit with an original maturity of three to twelve months.

Patient Receivables

Patient receivables are uncollateralized patient and third-party payor obligations. The Hospital does not charge interest on delinquent accounts. Payments of patient receivables are allocated to the specific claims identified in the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient 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 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.

Note Receivable

Note receivable represents an uncollateralized note receivable, issued at market value, from an individual who is seeking a medical degree as part of the Hospital's physician recruitment process. The note has been issued with forgiveness provisions that match the work commitment to encourage retention. Management reviews the note 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. The note receivable is included in other assets in the statements of net position.

Noncurrent Cash

Noncurrent cash represents cash which is held by a trustee for a reserve in accordance with the Hospital's certificates of participation.

Supplies

Supplies are stated at the lower of cost (first-in, first-out) or market.

Investment Income

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

Capital Assets

Property and equipment acquisitions in excess of \$5,000 are capitalized and recorded at cost. Depreciation is provided over the estimated useful life of each depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Amortization is included in depreciation and amortization in the financial statements. The estimated useful lives of capital assets are as follows:

| | |
|----------------------------|------------|
| Land improvements | 5-20 years |
| Buildings and improvements | 5-40 years |
| Fixed Equipment | 5-25 years |
| Equipment | 5-20 years |

Gifts of long-lived assets such as land, buildings, or equipment are reported as additions to unrestricted net position, and are excluded from revenues in excess of expenses. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted net position.

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 Hospital's deferred outflows of resources consist of unrecognized items not yet charged to pension expense and contributions from the employer after the pension measurement date but before the end of the employer's reporting period.

Discounts on Certificates of Participation

The certificates of participation are reported net of the applicable discounts. Discounts are amortized over the life of the certificates using the straight line method, which is a reasonable estimate of the effective interest method. Amortization is included in interest expense.

Compensated Absences

Hospital employees earn paid time off at various rates depending on years of service. Paid time off benefits is recognized when earned and is recorded as part of the employee's compensation. Employees also earn sick leave benefits based on hours worked. Sick leave benefits are not paid upon termination or leaving employment, thus are not accrued liabilities in the financial statements.

Pensions

For purposes of measuring the net pension assets, liabilities, 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 on by SDRS. The Hospital's contributions and net pension asset/liability 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. Deferred inflows of resources in the statements of net position consists of the unamortized portion of the net difference between projected and actual earnings on the pension plan investments.

Operating Revenues and Expenses

The Hospital'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 Hospital'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.

Financing Costs

Financing costs are expensed as incurred and included in interest expense in the statements of revenues, expenses and changes in net position.

Net Patient Service Revenue

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

Charity Care

The Hospital provides health care services to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Since the Hospital does not pursue collection of these amounts, they are not reported as patient service revenue. The estimated cost of providing these services was \$1,700 and \$14,500 for the years ended December 31, 2016 and 2015, calculated by multiplying the ratio of cost to gross charges for the Hospital by the gross uncompensated charges associated with providing charity care to its patients.

Grants and Contributions

The Hospital 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 revenues in excess of expenses.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses, natural disasters; 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 9.

Electronic Health Record (EHR) Incentives

The American Recovery and Reinvestment Act of 2009 (ARRA) amended the Social Security Act to establish incentive payments under the Medicare and Medicaid programs for certain hospitals and professionals that meaningfully use certified Electronic Health Records (EHR) technology.

To qualify for the EHR incentive payments, hospitals and physicians must meet designated EHR meaningful use criteria. In addition, hospitals must attest that they have used certified EHR technology, satisfied the meaningful use objectives, and specify the EHR reporting period. This attestation is subject to audit by the federal government or its designee. The EHR incentive payment to hospitals for each payment year is calculated as a product of (1) allowable costs as defined by the Centers for Medicare & Medicaid Services (CMS) and (2) the Medicaid share. Once the initial attestation of meaningful use is completed, critical access hospitals receive the entire EHR incentive payment for submitted allowable costs of the respective periods in a lump sum, subject to a final adjustment on the cost report.

The Hospital recognizes EHR incentive payments when there is reasonable assurance that the Hospital will comply with the conditions attached to the incentive payments. The amount of EHR incentive payments recognized are based on management's best estimate and those amounts are subject to change with such changes impacting the period in which they occur.

The Hospital recognized revenue of \$-0- and \$33,700 for the years ended December 31, 2016 and 2015 related to EHR incentive payments.

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 Service Revenue

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

Medicare – The Hospital is licensed as a Critical Access Hospital (CAH). The Hospital is reimbursed for most acute care services under a cost-based reimbursement methodology with final settlement determined after submission of annual cost reports by the Hospital and are subject to audits thereof by the Medicare Administrative Contractor (MAC). The Hospital's Medicare cost reports have been audited by the MAC through the year ended December 31, 2014. Clinical services are paid on a cost basis or fixed fee schedule.

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. Clinical and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a reimbursement methodology based on historical costs. There are no retroactive settlements resulting from the Medicaid program.

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

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

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

| | 2016 | 2015 |
|---------------------------------------|------|------|
| Medicare | 52% | 57% |
| Medicaid | 4% | 5% |
| Blue Cross | 18% | 17% |
| Other third-party payors and patients | 26% | 21% |
| | 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 service revenue for the year ended December 31, 2016 increased approximately \$33,000 and the net patient service revenue for the year ended December 31, 2015 decreased approximately \$94,000 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 amount of deposits as of December 31, 2016 and 2015 are as follows:

| | 2016 | 2015 |
|-------------------------|--------------|--------------|
| Carrying Amount | | |
| Cash and deposits | \$ 2,710,876 | \$ 1,607,437 |
| Certificates of deposit | 101,064 | 75,407 |
| | \$ 2,811,940 | \$ 1,682,844 |

Deposits and investments are reported in the following statement of net position captions:

| | 2016 | 2015 |
|--------------------------------------------------|--------------|--------------|
| Cash and cash equivalents | \$ 2,188,925 | \$ 1,078,065 |
| Short term investments | 101,064 | 75,407 |
| Noncurrent cash held by Trustee for debt service | 521,951 | 529,372 |
| | \$ 2,811,940 | \$ 1,682,844 |

Deposits – Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank or investment company failure, the Hospital's deposits may not be returned to it. State statute requires that any deposits in excess of federal depository or other insured amounts be collateralized by U.S. Government securities in the name of the Hospital. Statutes also require that the market value of the collateral be at least 100% of the excess deposits. The Hospital's deposit policy does not further restrict bank deposits or limit investment deposits.

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 Hospital does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Credit Risk

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).

Concentration of Credit Risk

The Hospital does not have a formally adopted investment policy for managing concentration of credit risk.

Investment Income

Investment income consists of interest earned on the Hospital's certificates of deposit, cash and cash equivalents.

Note 4 - Capital Assets

Capital assets additions, retirements, transfers and balances for the year ended December 31, 2016 is as follows:

| | December 31, 2015 | Additions | Disposals | December 31, 2016 |
|-------------------------------------------|----------------------|------------|--------------|----------------------|
| Capital assets not being depreciated | | | | |
| Land | \$ 5,000 | \$ - | \$ - | \$ 5,000 |
| Capital assets being depreciated | | | | |
| Land improvements | \$ 127,454 | \$ - | \$ - | \$ 127,454 |
| Buildings | 6,367,661 | 54,644 | - | 6,422,305 |
| Fixed equipment | 4,767,117 | - | - | 4,767,117 |
| Major moveable equipment | 2,519,581 | 552,863 | (336,069) | 2,736,375 |
| Total capital assets being depreciated | 13,781,813 | 607,507 | (336,069) | 14,053,251 |
| Less accumulated depreciation for | | | | |
| Land improvements | 53,798 | 5,781 | - | 59,579 |
| Buildings | 3,050,572 | 177,972 | - | 3,228,544 |
| Fixed equipment | 1,817,520 | 226,990 | - | 2,044,510 |
| Major moveable equipment | 2,068,762 | 227,925 | (336,069) | 1,960,618 |
| Total accumulated depreciation | 6,990,652 | \$ 638,668 | \$ (336,069) | 7,293,251 |
| Net capital assets being depreciated | \$ 6,791,161 | | | \$ 6,760,000 |
| Capital assets, net | \$ 6,796,161 | | | \$ 6,765,000 |

Community Memorial Hospital
Notes to Financial Statements
December 31, 2016 and 2015

Capital assets additions, retirements, transfers and balances for the year ended December 31, 2015 is as follows:

| | December 31, 2014 | Additions | Disposals | December 31, 2015 |
|-------------------------------------------|----------------------|-------------------|---------------------|----------------------|
| Capital assets not being depreciated | | | | |
| Land | \$ 5,000 | \$ - | \$ - | \$ 5,000 |
| Capital assets being depreciated | | | | |
| Land improvements | \$ 127,454 | \$ - | \$ - | \$ 127,454 |
| Buildings | 6,382,454 | - | (14,793) | 6,367,661 |
| Fixed equipment | 4,767,117 | - | - | 4,767,117 |
| Major moveable equipment | 2,618,326 | 10,251 | (108,996) | 2,519,581 |
| Total capital assets being depreciated | <u>13,895,351</u> | <u>10,251</u> | <u>(123,789)</u> | <u>13,781,813</u> |
| Less accumulated depreciation for | | | | |
| Land improvements | 47,791 | 6,007 | - | 53,798 |
| Buildings | 2,887,136 | 178,229 | (14,793) | 3,050,572 |
| Fixed equipment | 1,590,996 | 226,524 | - | 1,817,520 |
| Major moveable equipment | 2,005,156 | 172,602 | (108,996) | 2,068,762 |
| Total accumulated depreciation | <u>6,531,079</u> | <u>\$ 583,362</u> | <u>\$ (123,789)</u> | <u>6,990,652</u> |
| Net capital assets being depreciated | <u>\$ 7,364,272</u> | | | <u>\$ 6,791,161</u> |
| Capital assets, net | <u>\$ 7,369,272</u> | | | <u>\$ 6,796,161</u> |

Note 5 - Capital Lease Obligations

The Hospital leases certain equipment under non-cancelable long-term lease agreements. Certain leases have been recorded as capitalized leases and others as operating leases. Total lease expense for the years ended December 31, 2016 and 2015 for all operating leases was \$20,867 and \$15,176. The capitalized leased assets consist of:

| | 2016 | 2015 |
|-------------------------------|------------------|------------------|
| Major moveable equipment | \$ 41,800 | \$ 309,424 |
| Less accumulated amortization | (30,852) | (220,132) |
| | <u>\$ 10,948</u> | <u>\$ 89,292</u> |

Minimum future lease payments for the capital leases are as follows:

Years Ending December 31,

| | |
|--------------------------------------------------|-------------------------|
| 2017 | \$ 12,283 |
| Less interest | <u>(346)</u> |
| Present value of minimum lease payments - Note 6 | <u><u>\$ 11,937</u></u> |

Note 6 - Long-Term Debt

A summary of changes in the Hospital's long-term debt for the years ended December 31, 2016 and 2015 follows:

| | December 31, 2015 | Additions | Reductions | December 31, 2016 | Current Portion |
|---------------------------------------------|----------------------------|----------------------------|------------------------------|----------------------------|--------------------------|
| Series 2015 - Certificates of Participation | \$ 7,635,000 | \$ - | \$ (200,000) | \$ 7,435,000 | \$ 200,000 |
| Series 2015 - Unamortized Discount | (67,938) | - | 313 | (67,625) | - |
| 2015 Note payable | 438,301 | - | (95,340) | 342,961 | 98,740 |
| Capital lease obligations (Note 5) | <u>61,260</u> | <u>-</u> | <u>(49,323)</u> | <u>11,937</u> | <u>11,937</u> |
| | <u><u>\$ 8,066,623</u></u> | <u><u>\$ -</u></u> | <u><u>\$ (344,350)</u></u> | <u><u>\$ 7,722,273</u></u> | <u><u>\$ 310,677</u></u> |
| | December 31, 2014 | Additions | Reductions | December 31, 2015 | Current Portion |
| Series 2015 - Certificates of Participation | \$ - | \$ 7,635,000 | \$ - | \$ 7,635,000 | \$ 200,000 |
| Series 2015 - Unamortized Discount | - | (71,679) | 3,741 | (67,938) | - |
| 2015 Note payable | - | 500,000 | (61,699) | 438,301 | 95,318 |
| Series 2008 - Certificates of Participation | 7,545,000 | - | (7,545,000) | - | - |
| Series 2008 - Unamortized Discount | (43,385) | - | 43,385 | - | - |
| Note payable | 98,601 | - | (98,601) | - | - |
| Capital lease obligations (Note 5) | <u>118,286</u> | <u>-</u> | <u>(57,026)</u> | <u>61,260</u> | <u>49,323</u> |
| | <u><u>\$ 7,718,502</u></u> | <u><u>\$ 8,063,321</u></u> | <u><u>\$ (7,715,200)</u></u> | <u><u>\$ 8,066,623</u></u> | <u><u>\$ 344,641</u></u> |

Long-term debt maturities are as follows:

| <u>Years Ending December 31,</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|----------------------------------|---------------------|---------------------|----------------------|
| 2017 | \$ 310,677 | \$ 327,317 | \$ 637,994 |
| 2018 | 302,241 | 320,294 | 622,535 |
| 2019 | 315,867 | 312,513 | 628,380 |
| 2020 | 246,113 | 304,626 | 550,739 |
| 2021 | 220,000 | 298,458 | |
| 2022 to 2026 | 1,205,000 | 1,373,640 | 2,578,640 |
| 2027 to 2031 | 1,485,000 | 1,101,004 | 2,586,004 |
| 2032 to 2036 | 1,880,000 | 716,021 | 2,596,021 |
| 2037 to 2040 | 1,825,000 | 211,000 | 2,036,000 |
| | <u>7,789,898</u> | <u>4,964,873</u> | <u>12,236,313</u> |
| Less unamortized discount | <u>(67,625)</u> | <u>-</u> | <u>-</u> |
| | <u>\$ 7,722,273</u> | <u>\$ 4,964,873</u> | <u>\$ 12,236,313</u> |

Certificates of participation relate to debt issued by the City of Redfield to facilitate the financing of public capital projects. The City of Redfield leases the assets acquired with the proceeds from the certificates of participation under a ground lease agreement. For financial reporting purposes, the Hospital accounts for the certificates of participation as its own debt.

Proceeds from the series 2015 certificates of participation were used to advance refund the Hospital's series 2008 certificates of participation. The 2015 certificates carry interest rates ranging from 1.45% to 5.0% and come due in various biannual amounts up through the Hospital's fiscal year ending December 31, 2040.

The series 2008 certificates of participation originally matured in various installments, with a final balloon payment of \$7,125,000 due on December 1, 2018. The 2008 certificates of participation had interest rates ranging from 6.375% to 7.125%.

The 2015 note payable has an interest rate of 3.49% and is due in monthly payments of \$9,095 through April 1, 2020 and is secured by the general assets of the City.

During the year ended December 31, 2015, the Hospital paid off its note payable which had an original due date of June 2016. The original terms of the note payable called for monthly payments of \$5,735 and carried an interest rate of 4.75% and was secured by the Hospital's accounts receivable and general assets.

Under terms of the certificates of participation, the Hospital is required to maintain certain deposits with a trustee. Such deposits are included with restricted assets in the financial statements. The agreement also place limitations on additional borrowings, requiring that the Hospital satisfy certain measures of financial performance, before any additional borrowing is allowed.

Note 7 - Concentration of Credit Risk

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

| | 2016 | 2015 |
|----------------------|------|------|
| Medicare | 37% | 36% |
| Commercial insurance | 47% | 33% |
| Medicaid | 7% | 5% |
| Self pay | 9% | 26% |
| | 100% | 100% |

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 Hospital's share of contributions to the SDRS for the years ending December 31, 2016, 2015, and 2014 was \$312,368, \$303,209, and \$306,087 respectively.

Pension Assets/liabilities, Pension 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 Hospital as of December 31, 2016 and 2015 are as follows:

| | 2016 | 2015 |
|---------------------------------------------------------------------|---------------|---------------|
| Proportionate share of net position restricted for pension benefits | \$ 28,161,833 | \$ 30,084,277 |
| Less proportionate share of total pension liability | 29,066,653 | 28,900,260 |
| Proportionate share of net pension (liability) asset | \$ (904,820) | \$ 1,184,017 |

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 Hospital reported a liability of \$904,820, and at December 31, 2015 an asset of \$1,184,017 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 Hospital's share of contributions to the pension plan relative to the contributions of all participating entities. At June 30, 2016 and 2015, the Hospital's proportion was 0.2678645% and 0.2791647%, respectively.

For the years ended December 31, 2016 and 2015, the Hospital recognized pension expense of \$654,657 and \$136,981, respectively.

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

| | 2016 | |
|--------------------------------------------------------------------------------------------------------------|--------------------------------------|-------------------------------------|
| | Deferred Outflows of Resources | Deferred Inflows of Resources |
| Difference between expected and actual experience | \$ 314,989 | \$ - |
| Changes in assumption | 541,943 | - |
| Net difference between projected and actual earnings on pension plan investments | 1,006,466 | - |
| Changes in proportion and difference between Hospital contributions and proportionate share of contributions | 61,125 | - |
| Hospital contributions subsequent to measurement date | 149,437 | - |
| Total | \$ 2,073,960 | - |

At December 31, 2016, there is \$149,437 reported as deferred outflows of resources related to pensions resulting from Hospital 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 | \$ 523,080 |
| 2018 | 324,422 |
| 2019 | 653,157 |
| 2020 | 423,864 |
| Total | \$ 1,924,523 |

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

| | 2015 | |
|---------------------------------------------------------------------------------------------------------------|--------------------------------------|-------------------------------------|
| | Deferred Outflows of Resources | Deferred Inflows of Resources |
| Difference between expected and actual experience | \$ 242,434 | \$ - |
| Changes in assumption | 938,850 | - |
| Net difference between projected and actual earnings on pension plan investments | - | 1,023,744 |
| Changes in proportion and difference between Authority contributions and proportionate share of contributions | 27,096 | - |
| Authority contributions subsequent to measurement date | 142,775 | - |
| Total | \$ 1,351,155 | \$ 1,023,744 |

At December 31, 2015, there was \$142,775 reported as deferred outflows of resources related to pensions resulting from Hospital contributions subsequent to the June 30, 2015 measurement date that was recognized as a 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:

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

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 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 Hospital’s proportionate share of net pension (liability) asset at June 30, 2016 calculated using the discount rate of 7.25% through 2017 and 7.50% thereafter, as well as what the Hospital’s proportionate share of the net pension (liability) asset would be if it were calculated using a discount rate that is 1 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 |
|---------------------------------------------------------------------|----------------|--------------------------|--------------|
| Hospital's proportionate share of the net pension (liability) asset | \$ (5,063,360) | \$ (904,820) | \$ 2,486,916 |

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 - Contingencies

Malpractice Insurance

The Hospital 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.

Litigation, Claims, and Disputes

The Hospital 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 any litigation, claims, and disputes in process will not be material to the financial position, operations, or cash flows of the Hospital.

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 Hospital is in substantial compliance with current laws and regulations.



Required Supplemental Information
December 31, 2016 and 2015

Community Memorial Hospital

Community Memorial Hospital
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 | \$ 312,368 | \$ 303,209 | \$ 306,387 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Contributions in relation to the contractually required contribution | <u>312,368</u> | <u>303,209</u> | <u>306,387</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> |
| Hospital's covered employee payroll | \$ 5,111,350 | \$ 4,957,677 | \$ 4,977,063 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Contributions as a percentage of covered employee payroll | 6.11% | 6.12% | 6.16% | | | | | | | |

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

Community Memorial Hospital
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 |
| Hospital's proportion of the net pension liability (asset) | 0.2678645% | 0.2791647% | 0.2875452% | % | % | % | % | % | % | % |
| Hospital's proportionate share of net pension liability (asset) | \$ 904,820 | \$ (1,184,017) | \$ (2,071,646) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Hospital's covered employee payroll | \$ 4,985,511 | \$ 4,995,346 | \$ 4,891,100 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Hospital's proportionate share of the net pension liability (asset) as a percentage of its covered employee payroll | 18.15% | -23.70% | -42.36% | | | | | | | |
| 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 Hospital 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 Governors
Community Memorial Hospital
Redfield, 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 Community Memorial Hospital (Hospital), an enterprise fund of the City of Redfield, South Dakota, 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 24, 2017.

Internal Control over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified a certain deficiency in internal control that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as finding 2016-A to be a material weakness.

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. We consider the deficiency described as 2016-B in the accompanying schedule of findings and responses to be a significant deficiency.

Compliance and Other Matters

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

Hospital's Response to Findings

The Hospital's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Hospitals' response was 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 Hospital's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity'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.

A handwritten signature in cursive script that reads "Eide Sallie LLP".

Sioux Falls, South Dakota
April 24, 2017

Findings – Financial Statement Audit

Finding No. 2016-A Preparation of Financial Statements and Material Adjusting Journal Entries

| | |
|--------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Criteria: | Proper controls over financial reporting include an adequate system for recording and processing entries material to the financial statements, as well as the ability to prepare financial statements and accompanying notes to the financial statements that are materially correct. |
| Condition: | The Hospital's internal control system is designed to provide monthly financial statements; however, it does not allow for the preparation of the annual financial statements including notes and disclosures as required by generally accepted accounting principles. As auditors, we were requested to draft the financial statements and accompanying notes to the financial statements. This circumstance is not unusual for an organization with limited staffing. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations. Additionally, we proposed material adjusting journal entries as a result of our audit procedures. The entries were primarily in the area of the allowance for doubtful accounts, third party payor settlements and pension related assets or liabilities, deferred inflows and deferred outflows of resources. These entries may not be identified as a result of the Hospital's existing internal controls. |
| Cause: | The Hospital has limited resources in the financial reporting process to prepare full disclosure financial statements. |
| Effect: | This deficiency results in a reasonable possibility that the Hospital would not be able to draft the financial statements and the accompanying notes to the financial statements that are materially correct without the assistance of the auditors. |
| Recommendation: | While we recognize that this condition is not unusual for an organization with limited staffing, it is important that you be aware of this condition for financial reporting purposes. We also suggest the Hospital review the methodology used in establishing the allowance for doubtful accounts and reviewing the appropriateness of the third party payor estimate. Management and the Board should continually be aware of the financial reporting of the Hospital and changes in reporting requirements. |
| View of Responsible Officials: | Management and the board of Governors will review for propriety the financial statements and footnotes prepared by the auditor. Management will review the audit adjustments and revise, as needed, any policies or procedures relating to the reconciliation process to prevent future material adjustments. |

Finding No. 2016-B Segregation of Duties

Criteria: The Hospital’s internal control structure should be designed such that the functions of executing transactions, recording transactions, and accountability for assets are performed by different individuals.

Condition: The limited size of office staff does not provide for adequate segregation of duties.

Cause: The Hospital has a limited number of office personnel within the accounting department.

Effect: Inadequate segregation of duties could adversely affect the Hospital’s ability to detect misstatements that would be significant in relation to the financial statements in a timely period by employees in the normal course of performing their assigned functions.

Recommendation: While we recognize that your office staff may not be large enough to assure optimal internal control, it is important that you are aware of this condition. Under this condition, the Board of Governors close supervision and review of accounting information is the best means of preventing and detecting errors and irregularities.

View of Responsible
Officials: Management plans to review this finding to determine whether cost effective solutions exist to improve this deficiency.



To the Board of Governors
Community Memorial Hospital
Redfield, South Dakota

We have audited the financial statements of Community Memorial Hospital as of and for the year ended December 31, 2016, and have issued our report thereon dated April 24, 2017. Professional standards require that we advise you of the following matters relating to our audit.

Our Responsibility in Relation to the Financial Statement Audit

As communicated in our engagement letter dated January 23, 2017, our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of its respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the Organization solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, as appropriate, our firm, and other firms utilized in the engagement, if applicable, have complied with all relevant ethical requirements regarding independence.

Qualitative Aspects of the Entity's Significant Accounting Practices

Significant Accounting Policies

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by Community Memorial Hospital is included in Note 1 to the financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during 2016. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements are were:

Estimated Third Party Payor Settlements – Management's estimate of the amounts either owed to or receivable from third-party payors is based on both final and tentatively settled cost reports. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. There is a reasonable possibility that recorded estimates will change by a material amount in the near term. Management believes that the estimates for all open years are adequate. Any differences between the estimates and the final settlements will be recorded in the period the final settlements are made and will not be treated as prior period adjustments.

Allowance for Contractuals and Doubtful Accounts – Management's estimate of the allowance for contractuals and doubtful accounts is based on historical loss levels and an analysis of the collectability of individual accounts.

Net Pension Asset or Liability, Deferred Outflows and Inflows of Resources and Pension Expense – Management's estimate of the net pension asset or liability and deferred outflows and inflows of resources, and pension expense related to the implementation of GASB 68 and GASB 71, these standards required the Hospital to calculate, recognize, and report the costs and obligations associated with pensions in their financial statements. These amounts were all determined based on the Hospital's proportionate share of the South Dakota Retirement System's (SDRS) estimated net pension asset or liability, deferred outflows and inflows of resources and pension expense, which utilized projections of future contributions and future earnings, actuarial assumptions such as inflation, salary increases, mortality rates and investment rate of return and discount rates in the determination of the final balances reported in the SDRS's audited financial statements. This Hospital's proportionate share was determined by calculating the Hospital's share of contributions to the pension plan relative to the contributions of all participating entities in the plan.

We evaluated the key factors and assumptions used to develop the estimates related to estimated third-party payor settlements, the collectability of patient receivables, and net pension asset or liability, deferred outflows and inflows of resources and pension expense in determining that they are reasonable in relation to the basic financial statements taken as a whole.

Significant Difficulties Encountered during the Audit

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

Uncorrected and Corrected Misstatements

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

The following misstatements that we identified as a result of our audit procedures were brought to the attention of, and corrected by, management:

- Entry to reduce bad debt allowances for patient receivables and bad debt expense for \$75,000.
- Various entries to record the impact of GASB 68, resulting in a decrease to non-current assets of 461,212, a decrease to non-current liabilities of \$118,924, and an increase to pension expense of \$342,288.
- Entry to reclassify federal withholding payable of \$21,092 and FICA accrual of \$29,240 out of the accounts payable and into the proper accrual accounts.
- Entry to reduce estimated payable for third party settlements and contractual adjustments in the amount of \$236,297.

The effect of these entries was to decrease the Hospital's net position by \$30,991.

The following summarizes uncorrected financial statement misstatements whose effects in the current and prior periods, as determined by management, are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

- An entry to reclassify credit balances in patient accounts receivable from current assets to current liabilities in the amount of \$32,198.

The effect of these uncorrected misstatements, including the effect of the reversal of prior year uncorrected misstatements as of and for the year ended December 31, 2015, is an overstatement of net income and an understatement of net position of \$19,387.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Representations Requested from Management

We have requested certain written representations from management, which are included in the management representation letter dated April 24, 2017.

Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Other Significant Matters, Findings, or Issues

In the normal course of our professional association with Community Memorial Hospital, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the Organization's auditors.

We applied certain limited procedures to the Schedules of Pension Contributions, and Proportionate Share of Net Pensions Liability (Asset), which are required supplementary information (RSI) that supplement the basic financial statements. Our procedures consisted of inquires of management regarding 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 did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

This report is intended solely for the information and use of the Board of Governors and management of Community Memorial Hospital and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Eide Sully LLP".

Sioux Falls, South Dakota
April 24, 2017