

***DOUGLAS COUNTY MEMORIAL HOSPITAL  
INDEPENDENT AUDITOR'S REPORT  
AND  
FINANCIAL STATEMENTS  
FOR THE YEARS ENDED  
MAY 31, 2017 AND 2016***

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Trustees of  
Douglas County Memorial Hospital  
Armour, South Dakota

*Report on the Financial Statements*

We have audited the accompanying financial statements of Douglas County Memorial Hospital (a nonprofit health care entity), which comprise the statements of financial position as of May 31, 2017 and 2016, and the related statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the 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. 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 financial position of Douglas County Memorial Hospital as of May 31, 2017 and 2016, and the results of its operations, changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Mitchell, South Dakota  
October 25, 2017

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
STATEMENTS OF FINANCIAL POSITION**

<b>ASSETS</b>	<b>MAY 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 3,046,603	\$ 1,829,006
Certificates of deposit	451,765	448,832
Patient receivables, net of allowances of \$721,000 in 2017 and \$766,500 in 2016	1,836,649	1,443,644
Inventories	444,318	454,845
Due from third parties	--	177,746
Prepaid expenses	41,836	48,312
<i>Total Current Assets</i>	5,821,171	4,402,385
<b>OTHER RECEIVABLE -- PHYSICIAN LOAN</b>	1,788	10,746
<b>PROPERTY, PLANT, AND EQUIPMENT, at cost</b>		
Land	74,425	71,625
Buildings	7,047,330	6,965,624
Major movable equipment	1,722,310	1,683,114
<i>Total Property and Equipment</i>	8,844,065	8,720,363
Less accumulated depreciation	2,709,026	2,410,586
<i>Total Property and Equipment, at cost</i>	6,135,039	6,309,777
<b>OTHER ASSETS</b>		
Investments	574,124	513,322
USDA Reserve Account	173,040	173,040
<i>Total Other Assets</i>	747,164	686,362
	<b>\$ 12,705,162</b>	<b>\$ 11,409,270</b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Current portion of long-term debt	\$ 49,500	\$ 48,000
Accounts payable	213,020	240,948
Accrued payroll liabilities	435,448	408,596
Due to third parties	135,000	--
Deposits - Prairie Villa	3,500	4,250
<i>Total Current Liabilities</i>	836,468	701,794
<b>LONG TERM DEBT, net of current portion</b>	3,316,499	3,366,000
<i>Total Liabilities</i>	4,152,967	4,067,794
<b>NET ASSETS</b>		
Unrestricted	8,552,195	7,341,476
	<b>\$ 12,705,162</b>	<b>\$ 11,409,270</b>

*The accompanying Notes to Financial Statements are  
an integral part of this statement.*

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**

	<i>YEARS ENDED</i>	
	<i>MAY 31,</i>	
	<i>2017</i>	<i>2016</i>
<b><i>UNRESTRICTED REVENUES</i></b>		
Net patient service revenue	\$ 9,843,343	\$ 8,723,422
Other operating revenue	158,806	166,287
<i>Total Unrestricted Revenues</i>	<u>10,002,149</u>	<u>8,889,709</u>
<b><i>OPERATING EXPENSES</i></b>		
Nursing service	1,219,718	1,157,375
Other professional service	4,032,862	3,966,816
General service	537,338	511,991
Fiscal and administrative service	1,133,650	1,043,228
Clinics	1,591,655	1,526,142
Depreciation	287,604	267,159
Interest Expense	118,642	120,295
<i>Total Operating Expenses</i>	<u>8,921,469</u>	<u>8,593,006</u>
 <i>Income From Operations</i>	 <u>1,080,680</u>	 <u>296,703</u>
<b><i>NON-OPERATING REVENUES</i></b>		
Interest Income	18,839	7,261
Gain on sale of property and equipment	--	10,000
Contributions	5,359	3,429
Assisted living -net	57,953	70,494
Net unrealized gain on investments	47,888	10,060
<i>Net Non-Operating Revenues</i>	<u>130,039</u>	<u>101,244</u>
 <i>CHANGE IN NET ASSETS</i>	 1,210,719	 397,947
 <i>NET ASSETS, Beginning of Year</i>	 <u>7,341,476</u>	 <u>6,943,529</u>
 <i>NET ASSETS, End of Year</i>	 <u>\$ 8,552,195</u>	 <u>\$ 7,341,476</u>

*The accompanying Notes to Financial Statements are  
an integral part of this statement.*

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
STATEMENTS OF CASH FLOWS**

	<i>YEARS ENDED</i>	
	<i>MAY 31,</i>	
	<i>2017</i>	<i>2016</i>
<b><i>CASH FLOWS FROM OPERATING ACTIVITIES:</i></b>		
Cash received from patients and third-party payors	\$ 10,375,566	\$ 9,230,366
Cash paid to suppliers and employees	(8,866,983)	(8,481,803)
Other receipts	5,359	3,429
Interest paid	(118,642)	(120,388)
Interest received	18,839	7,261
	<u>1,414,139</u>	<u>638,865</u>
<b><i>NET CASH PROVIDED BY OPERATING ACTIVITIES</i></b>		
<b><i>CASH FLOWS FROM INVESTING ACTIVITIES:</i></b>		
Proceeds from sale of property and equipment	--	10,000
Purchase of property and equipment	(141,652)	(98,996)
Purchase of certificates of deposit	(2,933)	(1,310)
Purchase of investments	(12,914)	(503,262)
(Increase) decrease in note receivable	8,958	5,208
	<u>(148,541)</u>	<u>(588,360)</u>
<b><i>NET CASH (USED) BY INVESTING ACTIVITIES</i></b>		
<b><i>CASH FLOWS FROM FINANCING ACTIVITIES:</i></b>		
Principal repayments under long term debt	(48,001)	(46,353)
	<u>(48,001)</u>	<u>(46,353)</u>
<b><i>NET INCREASE IN CASH AND CASH EQUIVALENTS</i></b>		
	1,217,597	4,152
<b><i>CASH AND CASH EQUIVALENTS, Beginning of Year</i></b>	<u>1,829,006</u>	<u>1,824,854</u>
<b><i>CASH AND CASH EQUIVALENTS, End of Year</i></b>	<u>\$ 3,046,603</u>	<u>\$ 1,829,006</u>

*The accompanying Notes to Financial Statements are  
an integral part of this statement.*

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
STATEMENTS OF CASH FLOWS  
(CONTINUED)**

	<i>YEARS ENDED</i>	
	<i>MAY 31,</i>	
	<i>2017</i>	<i>2016</i>
<b>RECONCILIATION OF CHANGE IN NET ASSETS TO NET</b>		
<b>CASH PROVIDED BY OPERATING ACTIVITIES:</b>		
Change in net assets	\$ 1,210,719	\$ 397,947
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	316,390	300,577
(Gain) on sale of property and equipment	--	(10,000)
Net unrealized (gains) losses on investments	(47,888)	(10,060)
(Increase) decrease in:		
Patient receivables	(393,005)	(11,591)
Inventories	10,527	(5,140)
Due from third parties	177,746	(89,881)
Prepaid expenses	6,476	(18,512)
Increase (decrease) in:		
Accounts payable	(27,928)	85,922
Accrued payroll liabilities	26,852	(1,022)
Due to third parties	135,000	--
Deposits - Prairie Villa	(750)	625
	<u>                    </u>	<u>                    </u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 1,414,139</b>	<b>\$ 638,865</b>

*The accompanying Notes to Financial Statements are  
an integral part of this statement.*

**DOUGLAS COUNTY MEMORIAL HOSPITAL**  
**NOTES TO FINANCIAL STATEMENTS**  
**MAY 31, 2017 AND 2016**

**1. SIGNIFICANT ACCOUNTING POLICIES:**

**Organization:** Douglas County Memorial Hospital (the Hospital), located in Armour, SD is a nonprofit corporation organized under the laws of the State of South Dakota. The Hospital provides inpatient, outpatient, and emergency services for residents of south central South Dakota. The Hospital also operates clinics in the communities of Armour, Corsica, and Stickney. The Hospital is dedicated to the care of the sick and injured without regard to race, color, creed, or national origin.

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

**Cash and Cash Equivalents:** The Hospital considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

**Patient Receivables:** Patient receivables are shown at the net amount expected to be collected after due allowances for uncollectible accounts, based on aging of all the individual patient balances, and a contractual allowance for third-party payors. The provision of uncollectibles at May 31, 2017 and 2016 was \$496,000 and \$497,000, respectively. The provision for contractual allowances at May 31, 2017 and 2016 was \$242,500 and \$269,500, respectively.

**Inventories:** Inventories are stated at current cost, equal to the last paid invoice price.

**Property and Equipment:** Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. It is the Hospital's policy to expense assets with a purchase price of less than \$5,000.

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

**Investments:** The entity records investments in marketable securities with readily determinable market values and all investments in debt securities at their fair value. Unrealized gains and losses are included in the change in net assets in the accompanying statement of operations.

**Income Taxes:** The Hospital is a not-for-profit corporation and has been recognized as tax-exempt pursuant to Section 501(c) (3) of the Internal Revenue Code. The state of South Dakota does not levy an income tax.

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
MAY 31, 2017 AND 2016**

**1. SIGNIFICANT ACCOUNTING POLICIES: (continued)**

**Net Patient Service Revenue:** The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue 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 care to patients who meet certain criteria under its charity policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

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

**Estimated Malpractice Costs:** The provision for estimated medical malpractice claims includes estimates of the ultimate cost for both reported claims and claims incurred but not reported.

**Subsequent Events:** Subsequent events have been evaluated for potential recognition or disclosure in the financial statements through October 25, 2017, the date the financial statements were available to be issued.

**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:** Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization.

**Medicaid:** Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary.

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
MAY 31, 2017 AND 2016**

**2. NET PATIENT SERVICE REVENUE: (continued)**

Revenue from the Medicare and Medicaid programs accounted for approximately 57% and 4%, respectively, of the Hospital's net patient revenue for the year ended May 31, 2017, and 53% and 7% respectively of the Hospital's net patient revenue, for the year ended May 31, 2016. Laws and regulations governing the Medicare and Medicaid programs are 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 Hospital also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

**3. OPERATING LEASES:**

The Hospital leases equipment and expenses the payments as lease expense. Future operating lease obligations are as follows:

<u>Years Ended May 31,</u>	<u>Amount</u>
2018	\$ 40,756
2019	9,587
<i>Total</i>	<u>\$ 50,343</u>

The Hospital spent \$99,970 and \$102,429 on equipment operating leases for the fiscal year ended May 31, 2017 and 2016, respectively.

**4. REAL PROPERTY LEASE AGREEMENT:**

Commencing July 1, 2005, the Hospital entered into a lease agreement with Stickney Leasing, LLC, the owner of real property used by the Hospital for a clinic in Stickney. The initial lease term is for one year, with an automatic renewal for each subsequent year until terminated by either party. The building was sold in 2008 and the lease was assigned to Sauvage Enterprises, LLC. The annual lease payment is \$4,800.

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
MAY 31, 2017 AND 2016**

**5. MALPRACTICE CLAIMS:**

The Hospital is insured by a claims-made policy for protection against liability claims resulting from professional services provided or which should have been provided. Coverage limits are \$1,000,000 per claim and \$3,000,000 in the aggregate.

Presently no claims alleging malpractice have been asserted against the Hospital. However, incidents occurring through May 31, 2016 or 2017 may result in the assertion of claims. Other claims may be asserted arising from services provided to patients in the past. Management is unable to estimate the ultimate cost, if any, of the resolution of such potential claims; however management believes that these claims, if asserted, would be settled within the limits of insurance coverage.

**6. PENSION PLAN:**

The Hospital maintains a contributory defined contribution retirement plan for all eligible employees. The 403(b) pension plan is administered by CPI Qualified Plan Consultants.

Contributions are 5% of gross wages by electing employees, which are matched by the Hospital. The Hospital's pension expense for the years ended May 31, 2017 and 2016 was \$165,340 and \$166,655, respectively.

**7. ACCOUNTING FOR UNCERTAIN TAX POSITIONS:**

The Hospital files informational income tax returns in the U.S. federal jurisdiction. With few exceptions, the Hospital is no longer subject to U.S. federal, state, or local tax examinations by tax authorities for years before 2013.

The Hospital includes all penalties and interest assessed by income taxing authorities in operating expenses. The Hospital did not have penalties and interest expenses for the years ended May 31, 2017 and 2016.

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
MAY 31, 2017 AND 2016**

**8. LONG TERM DEBT:**

Long term debt consists of the following:

<i>Description</i>	<i>Terms</i>	<i>MAY 31,</i>	
		<i>2017</i>	<i>2016</i>
USDA Rural Development -- Secured by Building	3.5%; Payable in monthly installments of \$13,895, including interest. Final payment due July 10, 2052.	<u>3,365,999</u>	<u>3,414,000</u>
		3,365,999	3,414,000
	Less Current Portion	<u>(49,500)</u>	<u>(48,000)</u>
	Net Long Term Debt	<u>\$ 3,316,499</u>	<u>\$ 3,366,000</u>

For the years ended May 31, 2017 and 2016, the Hospital recorded interest expense of \$118,642 and \$120,625, respectively. The Hospital capitalized interest of approximately \$12,700 during the year ended May 31, 2017.

Estimated aggregate maturities of long-term debt for the years ended May 31, are as follows:

2018	\$	49,500
2019	\$	51,500
2020	\$	53,000
2021	\$	55,100
2022	\$	57,100

**DOUGLAS COUNTY MEMORIAL HOSPITAL**  
**NOTES TO FINANCIAL STATEMENTS**  
**MAY 31, 2017 AND 2016**

**9. CONCENTRATION OF CREDIT RISK:**

The Hospital maintains several bank accounts at BankWest in Armour, SD. Accounts at an institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. Balances at year end and at various times throughout the year exceeded federally insured limits.

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of May 31, 2017 and 2016 was as follows:

	<i>2017</i>	<i>2016</i>
Medicare	35.0%	39.0%
Medicaid	1.3%	1.9%
Blue Cross	9.1%	9.1%
Other third-party payors	17.6%	13.3%
Patients	37.0%	36.7%
	100.0%	100.0%

**10. INVESTMENTS:**

Investments at May 31, 2017 are summarized as follows:

	<i>Cost</i>	<i>Fair Value</i>	<i>Carrying Value</i>
<i>Investments, recorded at fair value:</i>			
Cash and cash equivalents	\$ --	\$ 5,885	\$ 5,885
Mutual Funds - Bonds	(10,926)	54,946	54,946
Mutual Funds - Equities	88,768	126,834	126,834
Exchange Traded Funds	486,521	386,459	386,459
	\$ 564,363	\$ 574,124	\$ 574,124

**11. FAIR VALUE MEASUREMENTS:**

FASB Accounting Standards Codification 820, Fair Value Measurements and Disclosures, establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the entity has the ability to access.

**DOUGLAS COUNTY MEMORIAL HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
MAY 31, 2017 AND 2016**

**11. FAIR VALUE MEASUREMENTS: (continued)**

Level 2 Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted process for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

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

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

The following table sets forth by level, within the fair value hierarchy, the entity's assets at fair value as of May 31, 2017:

	<i>Assets Measured at Fair Value at May 31, 2017</i>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 5,885	\$ --	\$ --	\$ 5,885
Mutual funds	181,780	--	--	181,780
Exchange traded funds	<u>386,459</u>	<u>--</u>	<u>--</u>	<u>386,459</u>
Total Assets Measured at Fair Value	<u>\$ 574,124</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 574,124</u>