

PHOEBE SUMTER MEDICAL CENTER, INC.



FINANCIAL STATEMENTS

for the years ended July 31, 2012 and 2011

## CONTENTS

---

	<u>Pages</u>
Independent Auditor's Report	1
Financial Statements:	
Balance Sheets	2-3
Statements of Operations and Changes in Net Assets	4
Statements of Cash Flows	5-6
Notes to Financial Statements	7-26
Independent Auditor's Report on Supplemental Information	27
Service to the Community	28-31

---

---

INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Phoebe Sumter Medical Center, Inc.  
Americus, Georgia

We have audited the accompanying balance sheets of Phoebe Sumter Medical Center, Inc. as of July 31, 2012 and 2011, and the related statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Phoebe Sumter Medical Center, Inc. as of July 31, 2012 and 2011, and the results of its operations and changes in net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*Driffin & Tucker, LLP*

Albany, Georgia  
November 29, 2012

PHOEBE SUMTER MEDICAL CENTER, INC.

BALANCE SHEETS, July 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current assets:		
Cash	\$ 4,999,719	\$ 7,678,765
Patient accounts receivable, net of allowance for doubtful accounts of \$18,200,000 in 2012 and \$16,100,000 in 2011	8,037,754	6,644,925
Supplies, at lower of cost (first-in, first-out) or market	889,497	716,527
Other current assets	<u>2,721,815</u>	<u>1,124,418</u>
Total current assets	<u>16,648,785</u>	<u>16,164,635</u>
Assets limited as to use:		
Internally designated for capital improvements	<u>4,133,579</u>	<u>4,080,130</u>
Property and equipment, net	<u>56,405,060</u>	<u>4,676,742</u>
Other assets:		
Physician notes receivable	596,616	2,157,465
Interest in net assets of Sumter Regional Hospital Foundation, Inc.	<u>2,638,396</u>	<u>2,507,812</u>
Total other assets	<u>3,235,012</u>	<u>4,665,277</u>
Total assets	<u>\$ 80,422,436</u>	<u>\$ 29,586,784</u>

	<u>2012</u>	<u>2011</u>
<b>LIABILITIES AND UNRESTRICTED NET ASSETS</b>		
Current liabilities:		
Accounts payable	\$ 937,991	\$ 924,651
Accrued expenses	3,544,384	3,195,226
Estimated third-party payor settlement	<u>952,155</u>	<u>15,655</u>
Total current liabilities	5,434,530	4,135,532
Related party payables	<u>8,379,193</u>	<u>11,013,617</u>
Total liabilities	13,813,723	15,149,149
Unrestricted net assets	<u>66,608,713</u>	<u>14,437,635</u>
Total liabilities and unrestricted net assets	\$ <u>80,422,436</u>	\$ <u>29,586,784</u>

See accompanying notes to financial statements.

PHOEBE SUMTER MEDICAL CENTER, INC.

STATEMENTS OF OPERATIONS AND  
CHANGES IN NET ASSETS  
for the years ended July 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Unrestricted revenues, gains, and other support:		
Net patient service revenue	\$ 62,114,256	\$ 56,522,742
Other revenue	<u>2,527,890</u>	<u>3,231,469</u>
Total revenues, gains, and other support	<u>64,642,146</u>	<u>59,754,211</u>
Expenses:		
Salaries and wages	17,727,172	15,658,916
Employee health and welfare	5,119,901	7,050,304
Medical supplies and other	22,390,177	26,197,045
Purchased services	7,381,054	6,246,047
Depreciation and amortization	4,710,901	1,276,693
Interest	-	8,972
Provision for bad debts	<u>11,385,934</u>	<u>10,238,182</u>
Total expenses	<u>68,715,139</u>	<u>66,676,159</u>
Operating loss	( 4,072,993)	( 6,921,948)
Nonoperating gains:		
Investment income and other	<u>142,465</u>	<u>421,803</u>
Excess expenses	( 3,930,528)	( 6,500,145)
Capital contributions	56,026,634	-
Change in unrealized loss on investments	( 55,612)	( 21,737)
Change in interest in net assets of Sumter Regional Hospital Foundation, Inc.	<u>130,584</u>	<u>( 45,275)</u>
Increase (decrease) in unrestricted net assets	52,171,078	( 6,567,157)
Unrestricted net assets, beginning of year	<u>14,437,635</u>	<u>21,004,792</u>
Unrestricted net assets, end of year	<u>\$ 66,608,713</u>	<u>\$ 14,437,635</u>

See accompanying notes to financial statements.

PHOEBE SUMTER MEDICAL CENTER, INC.

STATEMENTS OF CASH FLOWS  
for the years ended July 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Increase (decrease) in unrestricted net assets	\$ 52,171,078	\$( 6,567,157)
Adjustments to reconcile increase (decrease) in unrestricted net assets to net cash provided (used) by operating activities:		
Capital contributions	(56,026,634)	-
Change in unrealized gain (loss) on investments	55,612	21,737
Depreciation and amortization	4,710,901	1,276,693
Change in interest in net assets of Sumter Regional Hospital Foundation, Inc.	( 130,584)	45,275
Forgiveness of physician notes receivable	1,275,468	795,917
Changes in:		
Patient accounts receivable	( 1,392,829)	( 1,454,425)
Supplies	( 172,970)	125,396
Other current assets	( 1,597,397)	( 119,502)
Physician notes receivable	285,381	( 31,901)
Accounts payable	13,340	( 191,447)
Accrued expenses	349,158	1,625,163
Estimated third-party payor settlements	<u>936,500</u>	<u>( 379,833)</u>
Net cash provided (used) by operating activities	<u>477,024</u>	<u>( 4,854,084)</u>
Cash flows from investing activities:		
Purchase of property and equipment	( 412,585)	( 386,327)
Proceeds from sale of investments	2,236,152	17,180,731
Purchase of investments	<u>( 2,345,213)</u>	<u>(17,038,670)</u>
Net cash used by investing activities	<u>( 521,646)</u>	<u>( 244,266)</u>
Cash flows from financing activities:		
Payments on long-term debt	-	( 219,779)
Advances from related parties	15,780,830	17,648,776
Payments to related parties	<u>(18,415,254)</u>	<u>( 9,821,777)</u>
Net cash provided (used) by financing activities	<u>( 2,634,424)</u>	<u>7,607,220</u>

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

STATEMENTS OF CASH FLOWS, Continued  
for the years ended July 31, 2012 and 2011

---

	<u>2012</u>	<u>2011</u>
Net increase (decrease) in cash	\$( 2,679,046)	\$ 2,508,870
Cash at beginning of year	<u>7,678,765</u>	<u>5,169,895</u>
Cash at end of year	\$ <u>4,999,719</u>	\$ <u>7,678,765</u>

See accompanying notes to financial statements.

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS

---

1. Summary of Significant Accounting Policies

Organization

Phoebe Sumter Medical Center, Inc. (Hospital) was organized on January 5, 2009 as a nonprofit corporation and is a wholly owned subsidiary of Phoebe Putney Health System, Inc. (System).

On the evening of March 1, 2007, the Sumter Regional Hospital (SRH) was hit by a tornado which destroyed the main building and two ancillary buildings. From that date through April 1, 2008, the Hospital's operations were limited to urgent care and outpatient services. With the financial aid of the Federal and Georgia Emergency Management Agencies, and using its resources and proceeds under its property insurance policy, management contracted for the construction of a temporary hospital facility which was built on an adjacent site. This facility opened on April 1, 2008, and provided inpatient, outpatient, and emergency care services.

Effective June 30, 2009, the Americus-Sumter County Hospital Authority (Authority) implemented a reorganization plan for SRH whereby all the assets, management, and governance of SRH was transferred to Phoebe Sumter Medical Center, Inc., pursuant to a lease and transfer agreement. The lease term is forty years with an annual contribution of \$25,000 to the Authority. Under the lease and transfer agreement, the Authority was required to construct a new hospital facility. The new hospital facility was placed in service and leased to the Hospital for the remainder of the lease term. As part of the lease and transfer agreement, System agreed to contribute up to \$25,000,000 to the construction cost of the new facility or the physician recruiting efforts of the Hospital, as needed.

Use of Estimates

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

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

1. Summary of Significant Accounting Policies, Continued

Allowance For Doubtful Accounts

The Hospital provides an allowance for doubtful accounts based on an evaluation of the overall collectibility of the accounts receivable. As accounts are known to be uncollectible, the account is charged against the allowance.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in excess revenues (expenses) unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from excess revenues (expenses) unless the investments are trading securities. Loss on other than temporary impairment declines is included in excess revenues (expenses).

Assets Limited As To Use

Assets limited as to use primarily include designated assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion, subsequently use for other purposes.

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 on 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.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

1. Summary of Significant Accounting Policies, Continued

Property and Equipment, Continued

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from excess revenues (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.

Beneficial Interest in Net Assets of Foundation

The Hospital accounts for the activities of its related Foundation in accordance with FASB ASC 958-20, *Not-For-Profit Entities, Financially Interrelated Entities*. FASB ASC 958-20 establishes reporting standards for transactions in which a donor makes a contribution to a not-for-profit organization which accepts the assets on behalf of or transfers these assets to a beneficiary which is specified by the donor. Sumter Regional Hospital Foundation, Inc. (Foundation) accepts assets on behalf of the Hospital.

Excess Revenues (Expenses)

The statement of operations and changes in net assets includes excess revenues (expenses). Changes in unrestricted net assets which are excluded from excess revenues (expenses), consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

1. Summary of 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 care 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.

Estimated Malpractice and Other Self-Insurance Costs

The provisions for estimated medical malpractice claims and other claims under self-insurance plans include estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Income Taxes

The Hospital is a not-for-profit corporation that has been recognized as tax-exempt pursuant to Section 501(c)3 of the Internal Revenue Code.

The Hospital applies accounting policies that prescribe when to recognize and how to measure the financial statement effects of income tax positions taken or expected to be taken on its income tax returns. These rules require management to evaluate the likelihood that, upon examination by the relevant taxing jurisdictions, those income tax positions would be sustained. Based on that evaluation, the Hospital only recognizes the maximum benefit of each income tax position that is more than 50% likely of being sustained. To the extent that

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

1. Summary of Significant Accounting Policies, Continued

Income Taxes, Continued

all or a portion of the benefits of an income tax position are not recognized, a liability would be recognized for the unrecognized benefits, along with any interest and penalties that would result from disallowance of the position. Should any such penalties and interest be incurred, they would be recognized as operating expenses.

Based on the results of management's evaluation, no liability is recognized in the accompanying balance sheet for unrecognized income tax positions. Further, no interest or penalties have been accrued or charged to expense as of July 31, 2012 and 2011 or for the years then ended. The Hospital's open audit periods are for tax years 2009-2011.

Impairment of Long-Lived Assets

The Hospital evaluates on an ongoing basis the recoverability of its assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is required to be recognized if the carrying value of the asset exceeds the undiscounted future net cash flows associated with that asset. The impairment loss to be recognized is the amount by which the carrying value of the long-lived asset exceeds the asset's fair value. In most instances, the fair value is determined by discounted estimated future cash flows using an appropriate interest rate. The Hospital has not recorded any impairment charges in the accompanying statements of operations and changes in net assets for the years ended July 31, 2012 and 2011.

Fair Value Measurements

FASB ASC 820, *Fair Value Measurement and Disclosures* defines fair value as the amount that would be received for an asset or paid to transfer a liability (i.e., an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. FASB ASC 820 describes the following three levels of inputs that may be used:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets and liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

1. Summary of Significant Accounting Policies, Continued

Fair Value Measurements, Continued

- Level 2: Observable prices that are based on inputs not quoted on active markets but corroborated by market data.
- Level 3: Unobservable inputs when there is little or no market data available, thereby requiring an entity to develop its own assumptions. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Recently Issued Accounting Pronouncement

In 2012, the Hospital adopted the provisions of Financial Accounting Standards Board Accounting Standards Update (ASU) No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*. Under the ASU, anticipated insurance recoveries and estimated liabilities for medical malpractice claims or similar contingent liabilities are to be presented separately on the balance sheet. The Hospital's adoption of the ASU did not have a material effect on the financial statements.

In July 2011, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The ASU requires health care entities to change the presentation of the statement of operations by reclassifying the provision for doubtful accounts from an operating expense to a deduction from patient service revenues. Additionally, the guidance requires enhanced disclosures about the policies for recognizing revenue, assessing bad debts and qualitative and quantitative information about the changes in the allowance for doubtful accounts. The guidance is effective for fiscal years beginning after December 15, 2011, with early adoption permitted. The Hospital has not early adopted this guidance. While this standard will have no impact on the Hospital's financial position or results of operations, it will require the Hospital to reclassify the provision for bad debts from operating expenses to a component of net revenues for the fiscal year ended July 31, 2013, with retrospective application required.

Prior Year Reclassifications

Certain reclassifications have been made to the fiscal year 2011 financial statements to conform to the fiscal year 2012 presentation. These reclassifications had no impact on the change in net assets in the accompanying financial statements.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

1. Summary of Significant Accounting Policies, Continued

Subsequent Event

In preparing these financial statements, the Hospital has evaluated events and transactions for potential recognition or disclosure through November 29, 2012, the date the financial statements were available to be issued.

2. Net Patient Service Revenue

The Hospital has arrangements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. The Hospital does not believe that there are any significant credit risks associated with receivables due from third-party payors.

Revenue from the Medicare and Medicaid programs accounted for approximately 38% and 21%, respectively, of the Hospital's net patient revenue for the year ended July 31, 2012 and 41% and 21%, respectively, of the Hospital's net patient revenue for the year ended July 31, 2011. Laws and regulations governing the Medicare and Medicaid 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. Cost report estimated reimbursement amounts are adjusted in subsequent periods as final settlements are determined. The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. However, there has been an increase in regulatory initiatives at the state and federal levels including the initiation of the Recovery Audit Contractor (RAC) program and the Medicaid Integrity Contractor (MIC) program. These programs were created to review Medicare and Medicaid claims for medical necessity and coding appropriateness. The RAC's have authority to pursue improper payments with a three year look back from the date the claim was paid. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs.

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.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

2. Net Patient Service Revenue, Continued

- Medicare, Continued

The Hospital is reimbursed for certain 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 Administrative Contractor (MAC). 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 under contract with the Hospital. The Hospital's Medicare cost reports have been audited by the MAC through September 30, 2006.

- Medicaid

Inpatient acute care services rendered to Medicaid program beneficiaries are paid at a prospectively determined rate per admission. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services rendered to the 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. The Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through September 30, 2006.

The Hospital has also entered into contracts with certain managed care organizations to receive reimbursement for providing services to selected enrolled Medicaid beneficiaries. Payment arrangements with these managed care organizations consist primarily of prospectively determined rates per discharge, discounts from established charges, or prospectively determined per diems.

The Hospital participates in the Georgia Indigent Care Trust Fund (ICTF) Program. The Hospital receives ICTF payments for treating a disproportionate number of Medicaid and other indigent patients. ICTF payments are based on the Hospital's estimated uncompensated cost of services to Medicaid and uninsured patients. The amount of ICTF payments recognized in net patient service revenue was approximately \$1,544,000 and \$2,830,000 for the years ended July 31, 2012 and 2011, respectively.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

2. Net Patient Service Revenue, Continued

- Medicaid, Continued

The Medicare, Medicaid and SCHIP Benefits Improvement and Protection Act of 2000 (BIPA) provides for payment adjustments to certain facilities based on the Medicaid Upper Payment Limit (UPL). The UPL payment adjustments are based on a measure of the difference between Medicaid payments and the amount that could be paid based on Medicare payment principles. The net amount of UPL payment adjustments recognized in net patient service revenue was approximately \$205,000 and \$769,000 for the years ended July 31, 2012 and 2011, respectively.

During 2010, the state of Georgia enacted legislation known as the Provider Payment Agreement Act (the Act) whereby hospitals in the state of Georgia are assessed a “provider payment” in the amount of 1.45% of their net patient revenue. The Act became effective July 1, 2010, the beginning of state fiscal year 2011. The provider payments are due on a quarterly basis to the Department of Community Health. The payments are to be used for the sole purpose of obtaining federal financial participation for medical assistance payments to providers on behalf of Medicaid recipients. The provider payment will result in an increase in hospital payments on Medicaid services of approximately 11.88%. Approximately \$532,000 and \$320,000 relating to the Act is included in medical supplies and other in the accompanying statement of operations and changes in net assets for the years ended July 31, 2012 and 2011, respectively.

- Other Arrangements

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

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

3. Uncompensated Services

The Hospital was compensated for services at amounts less than its established rates. Charges for uncompensated services for the years ended July 31, 2012 and 2011 were approximately \$81,200,000 and \$74,900,000, respectively.

Uncompensated care includes charity and indigent care services of approximately \$6,500,000 and \$6,600,000 for the years ended July 31, 2012 and 2011, respectively. The cost of charity and indigent care services provided during the years ended July 31, 2012 and 2011 was approximately \$4,100,000 and \$4,100,000, respectively computed by applying a total cost factor to the charges foregone.

The following is a summary of uncompensated services and a reconciliation of gross patient charges to net patient revenue for the years ended July 31, 2012 and 2011.

	<u>2012</u>	<u>2011</u>
Gross patient charges	\$ <u>131,898,420</u>	\$ <u>121,139,016</u>
Uncompensated services:		
Charity and indigent care	6,525,430	6,560,828
Medicare	32,298,967	34,563,038
Medicaid	19,045,119	15,219,999
Other allowances	11,914,648	8,272,409
Bad debts	<u>11,385,934</u>	<u>10,238,182</u>
Total uncompensated care	81,170,098	74,854,456
Less bad debts	<u>11,385,934</u>	<u>10,238,182</u>
Deductions from patient service revenue	<u>69,784,164</u>	<u>64,616,274</u>
Net patient service revenue	\$ <u>62,114,256</u>	\$ <u>56,522,742</u>

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

4. Investments

Assets Limited as to Use

The composition of assets limited as to use as of July 31, 2012 and 2011 is set forth in the following table. Assets limited as to use are available for sale and are stated at fair value.

	<u>2012</u>	<u>2011</u>
By board for capital improvements:		
Money market funds	\$ 1,020,487	\$ 1,011,605
Corporate debt securities	2,099,966	1,998,564
Government debt securities	<u>1,013,126</u>	<u>1,069,961</u>
Total assets limited as to use	<u>\$ 4,133,579</u>	<u>\$ 4,080,130</u>

Investment income and gains and losses for the above are comprised of the following for the years ended July 31, 2012 and 2011.

	<u>2012</u>	<u>2011</u>
Income (loss):		
Interest income	\$ 110,000	\$ 264,894
Realized gains (losses)	( 28,212)	141,302
Investment expenses	<u>( 28,486)</u>	<u>( 53,458)</u>
	<u>\$ 53,302</u>	<u>\$ 352,738</u>
Other changes in unrestricted net assets:		
Unrealized gain (loss)	\$( <u>55,612</u> )	\$( <u>21,737</u> )

The Hospital's investments are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the accompanying financial statements.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

5. Property and Equipment

A summary of property and equipment at July 31, 2012 and 2011 follows:

	<u>2012</u>	<u>2011</u>
Land	\$ 1,501,139	\$ 1,501,139
Land improvements	2,709,055	462,426
Buildings and improvements	42,897,158	1,846,707
Equipment	<u>19,464,650</u>	<u>5,984,515</u>
	66,572,002	9,794,787
Less accumulated depreciation and amortization	<u>10,166,942</u>	<u>5,118,045</u>
Property and equipment, net	\$ <u>56,405,060</u>	\$ <u>4,676,742</u>

Depreciation expense for the years ended July 31, 2012 and 2011 amounted to approximately \$4,700,000 and \$1,300,000, respectively.

6. Physician Notes Receivable

Notes receivable consist primarily of loans secured by promissory notes to physicians under recruiting arrangements. In general, the loans are being forgiven over a period of time in which the physician practices medicine in Americus, Georgia. If the physician discontinues medical practice in this town, the outstanding principal and accrued interest becomes due immediately. The amounts forgiven and charged to expense during 2012 and 2011 were approximately \$1,275,000 and \$796,000, respectively.

Notes receivable also consist of educational loans to employees. In general, the educational loans are forgiven over a period of time in which the employee works for the Hospital.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

7. Defined Contribution Plan

Hospital employees may participate in the Phoebe Putney Health System 403(b) Deferred Savings Plan (Plan). All employees are eligible to participate in the Plan. Each employee may contribute up to 100% of their adjusted salary, up to the federal limit. The System matches 50% of each participant's contributions up to a maximum of 4%. Employees are fully vested in the System's matching contributions after three years of service. At its discretion, the Hospital may make additional contributions to the Plan. Contribution expense was \$776,000 and \$1,152,000 for the years ended July 31, 2012 and 2011, respectively.

8. Employee Health Insurance

The Hospital has a self-insurance program under which a third-party administrator processes and pays claims. The Hospital reimburses the third-party administrator for claims incurred and paid and has purchased stop-loss insurance coverage for claims in excess of \$150,000 for each individual employee. Total expenses related to this plan were approximately \$2,979,000 and \$3,915,000 for the years ended July 31, 2012 and 2011, respectively.

9. Malpractice Insurance

The Hospital is covered by a claims-made general and professional liability insurance policy with a specified deductible per incident and excess coverage on a claims-made basis through the parent's wholly owned subsidiary, Phoebe Putney Indemnity, LLC (PPI), located in South Carolina. Effective July 1, 2009, PPI added the Hospital as an additional insured under the policy. Under the policy endorsement, the limit of liability is \$750,000 for claims occurring prior to July 1, 2009 and \$5,000,000 for claims occurring on or after July 1, 2009.

PPI also provides excess liability coverage to the Hospital, which covers \$25,000,000 per occurrence in excess of the underlying insurance coverage of \$30,000,000 for the policy year ending July 31, 2012. The excess policy has an annual aggregate limit of \$25,000,000. All of the risk related to this coverage has been ceded to unrelated reinsurers via a contract of reinsurance.

Various claims and assertions have been made against the Hospital in its normal course of providing services. In addition, other claims may be asserted arising from services provided to patients in the past. In the opinion of management, adequate provision has been made for losses which may occur from such asserted and unasserted claims that are not covered by liability insurance.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

10. Concentrations of Credit Risk

The Hospital has operations in Americus, Georgia. The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor arrangements. The mix of receivables from patients and third-party payors at July 31, 2012 and 2011 was as follows:

	<u>2012</u>	<u>2011</u>
Medicare	22%	23%
Medicaid	15%	15%
Blue Cross	5%	4%
Other third-party payors	22%	16%
Patients	<u>36%</u>	<u>42%</u>
Total	<u>100%</u>	<u>100%</u>

At July 31, 2012, the Hospital had deposits at major financial institutions which exceeded the \$250,000 Federal Deposit Insurance Corporation limits. Management believes the credit risks related to these deposits are minimal.

11. Related Party Transactions

The System allocates management, administrative and certain physician clinic expenses. Management and administrative expenses allocated to the Hospital in 2012 and 2011 were approximately \$985,000 and \$808,000, respectively. Clinic expenses allocated to the Hospital in 2012 and 2011 were approximately \$5,569,000 and \$7,036,000, respectively. Allocated clinic expenses are unreimbursed costs for physician services provided to patients in the Hospital's service area.

12. Related Organization

The Foundation was established to raise funds to support the operation of the Hospital. The Foundation's bylaws provide that the majority of all funds raised, except for funds acquired for the operation of the Foundation, be distributed to or be held for the benefit of the Hospital. The Foundation's general funds, which represent the Foundation's unrestricted resources, are distributed to the Hospital in amounts and in periods determined by the Foundation's Board of Trustees, who may also restrict the use of general funds for hospital

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

12. Related Organization, Continued

plant replacement or other specific purposes. Plant replacement and expansion funds, and specific-purpose funds are distributed to the Hospital as required to comply with the purpose specified by donors. A summary of the Foundation's assets, liabilities, net assets, results of operations, and changes in net assets follows. The Hospital's interest in the net assets of the Foundation is reported as another asset in the balance sheets.

	<u>2012</u>	<u>2011</u>
Assets:		
Cash and cash equivalents	\$ 582,859	\$ 442,868
Investments	1,932,994	1,892,145
Other assets	<u>122,633</u>	<u>172,889</u>
Total assets	\$ <u>2,638,486</u>	\$ <u>2,507,902</u>
Liabilities and net assets:		
Accounts payable	\$ 90	\$ 90
Net assets	<u>2,638,396</u>	<u>2,507,812</u>
Total liabilities and net assets	\$ <u>2,638,486</u>	\$ <u>2,507,902</u>
Revenue and support	\$ 138,569	\$ 85,069
Expenses	<u>79,193</u>	<u>130,344</u>
Excess of revenue and support (expenses)	59,376	( 45,275)
Other changes in net assets	71,208	-
Net assets, beginning of year	<u>2,507,812</u>	<u>2,553,087</u>
Net assets, end of year	\$ <u>2,638,396</u>	\$ <u>2,507,812</u>

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

13. Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	<u>2012</u>	<u>2011</u>
Patient care services	\$ 42,938,122	\$ 46,146,242
General and administrative	9,680,182	9,006,070
Depreciation and amortization	4,710,901	1,276,693
Provision for bad debts	11,385,934	10,238,182
Interest expense	<u>-</u>	<u>8,972</u>
Total	<u>\$ 68,715,139</u>	<u>\$ 66,676,159</u>

14. Fair Value Measurement

Following is a description of the valuation methodologies used for assets at fair value. There have been no changes in the methodologies used at July 31, 2012 and 2011.

- *Money market:* Valued at amortized cost, which approximates fair value.
- *Corporate debt securities:* Certain corporate bonds are valued at the closing price reported in the active market in which the bond is traded. Other corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for identical and similar bonds, the bond is valued under a discounted cash flows approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.
- *Government debt securities:* Certain government debt securities are valued at the closing price reported in the active market in which the individual security is traded. Other government debt securities are valued based on yields currently available on comparable securities of issuers with similar credit ratings.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

14. Fair Value Measurement, Continued

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Hospital believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Fair values of assets measured on a recurring basis at July 31, 2012 and 2011 are as follows:

	<u>Fair Value</u>	<u>Fair Value Measurements At Reporting Date Using</u>		
		<u>Quoted Prices In Active Markets For Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
<u>July 31, 2012</u>				
Assets:				
Money market funds	\$ 1,020,487	\$ -	\$ 1,020,487	\$ -
Corporate debt securities	2,099,966	-	2,099,966	-
Government debt securities	<u>1,013,126</u>	<u>-</u>	<u>1,013,126</u>	<u>-</u>
Total assets	\$ <u>4,133,579</u>	\$ <u>-</u>	\$ <u>4,133,579</u>	\$ <u>-</u>
<u>July 31, 2011</u>				
Assets:				
Money market funds	\$ 1,011,605	\$ -	\$ 1,011,605	\$ -
Corporate debt securities	1,998,564	-	1,998,564	-
Government debt securities	<u>1,069,961</u>	<u>-</u>	<u>1,069,961</u>	<u>-</u>
Total assets	\$ <u>4,080,130</u>	\$ <u>-</u>	\$ <u>4,080,130</u>	\$ <u>-</u>

Financial assets valued using Level 2 inputs are based primarily on quoted prices for similar investments in active or inactive markets. Valuation techniques utilized to determine fair value are consistently applied.

All assets have been valued using a market approach.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

15. Commitments and Contingencies

Compliance Plan

The healthcare industry has recently been subjected to increased scrutiny from governmental agencies at both the federal and state level with respect to compliance with regulations. Areas of noncompliance identified at the national level include Medicare and Medicaid, Internal Revenue Service, and other regulations governing the healthcare industry. The Hospital has implemented a compliance plan focusing on such issues. There can be no assurance that the Hospital will not be subjected to future investigations with accompanying monetary damages.

Health Care Reform

In recent years, there has been increasing pressure on Congress and some state legislatures to control and reduce the cost of healthcare on the national or at the state level. In 2010, legislation was enacted which included cost controls on hospitals, insurance market reforms, delivery system reforms and various individual and business mandates among other provisions. The costs of certain provisions will be funded in part by reductions in payments by government programs, including Medicare and Medicaid. There can be no assurance that these changes will not adversely affect the Hospital.

Litigation

The Hospital is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations. See malpractice insurance disclosures in Note 9.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

16. Capital Contributions

During fiscal year 2012, construction of the new hospital was completed and in December 2011, the new facility was occupied by the Hospital. Effective with completion of the new facility and occupancy by the Hospital, the Authority transferred the new facility to the Hospital pursuant to the lease and transfer agreement dated June 30, 2009. As discussed in Note 1, the System agreed to fund the construction of the new facility in an amount not to exceed \$25,000,000 in the event that funding from the federal and state agencies, as well as insurance proceeds from the destruction of the previous facility, were inadequate to cover the cost of the new hospital facility. Funding of the \$25,000,000 for the construction has been recorded as a donation by the System. The Authority plans to repay the donation subject to receipt of funds from federal and state agencies and other third parties.

As of July 31, 2012, the Authority has funded approximately \$31,000,000 for the construction of the new facility. The transfer of the new facility has been recorded as a donation by the Authority.

17. Electronic Health Record Incentive Payments

The Health Information Technology for Economic and Clinical Health Act (the HITECH Act) was enacted into law on February 17, 2009, as part of the American Recovery and Reinvestment Act of 2009 (ARRA). The HITECH Act includes provisions designed to increase the use of Electronic Health Records (EHR) by both physicians and hospitals. Beginning with federal fiscal year 2011 and extending through federal fiscal year 2016, eligible hospitals participating in the Medicare and Medicaid programs are eligible for reimbursement incentives based on successfully demonstrating meaningful use of its certified EHR technology. Conversely, those hospitals that do not successfully demonstrate meaningful use of EHR technology are subject to reductions in Medicare reimbursements beginning in FY 2015. On July 13, 2010, the Department of Health and Human Services (DHHS) released final meaningful use regulations. Meaningful use criteria are divided into three distinct stages: I, II and III. The final rules specify the initial criteria for physicians and eligible hospitals necessary to qualify for incentive payments; calculation of incentive payment amounts; payment adjustments under Medicare for covered professional services and inpatient hospital services; eligible hospitals failing to demonstrate meaningful use of certified EHR technology; and other program participation requirements.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

---

17. Electronic Health Record Incentive Payments, Continued

The final rule set the earliest interim payment date for the incentive payment at May 2011. The first year of the Medicare portion of the program is defined as the federal government fiscal year October 1, 2010 to September 30, 2011.

The Hospital recognizes income related to Medicare and Medicaid incentive payments using a grant model based upon when it has determined that it is reasonably assured that the Hospital will be meaningfully using EHR technology for the applicable period and the cost report information is reasonably estimable.

As of July 31, 2012, the Hospital had not met the criteria for meaningful use for either the Medicare or Medicaid programs, and, therefore, received no payments under either program during FY 2012.

INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTAL INFORMATION

Board of Directors  
Phoebe Sumter Medical Center, Inc.  
Americus, Georgia

We have audited the financial statements of Phoebe Sumter Medical Center, Inc. as of and for the years ended July 31, 2012 and 2011 and our report thereon dated November 29, 2012, which expressed an unqualified opinion on those financial statements, appears on page 1. Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The information included in this report on pages 28 to 31, inclusive, which is the responsibility of management, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

*Draffin & Tucker, LLP*

Albany, Georgia  
November 29, 2012

## PHOEBE SUMTER MEDICAL CENTER, INC.

### SERVICE TO THE COMMUNITY

---

Phoebe Sumter Medical Center, Inc. (PSMC), formerly Sumter Regional Hospital, is a not-for-profit health care organization that exists to serve the community. PSMC opened in 1953 to serve the community by caring for the sick regardless of ability to pay. As a not-for-profit hospital, PSMC has no stockholders or owners. All revenue after expenses is reinvested in the mission to care for the citizens of the community – into clinical care, health programs, state-of-the-art technology and facilities, research and teaching and training of medical professionals now and for the future.

PSMC operates as a charitable organization consistent with the requirements of Internal Revenue Code Section 501(c)(3) and the “community benefit standard” of IRS Revenue Ruling 69-545. PSMC takes seriously its responsibility as the community’s safety net hospital and has a strong record of meeting and exceeding the charitable care and the organizational and operational standards required for federal tax-exempt status. PSMC demonstrates a continued and expanding commitment to meeting its mission and serving the citizens by providing community benefits. A community benefit is a planned, managed, organized, and measured approach to meeting identified community health needs, requiring a partnership between the healthcare organization and the community to benefit residents through programs and services that improve health status and quality of life.

PSMC improves the health and well being of Southwest Georgia through clinical services, education, research, and partnerships that build health capacity in the community. The PSMC provides community benefits for all citizens as well as for the medically underserved. The PSMC conducts community needs assessments and pays close attention to the needs of low income and other vulnerable persons and the community at large. PSMC often works with community groups to identify needs, strengthen existing community programs, and plan newly needed services. It provides a wide-ranging array of community benefit services designed to improve community health and the health of individuals and to increase access to health care, in addition to providing free and discounted services to people who are uninsured and underinsured. Drawing on a dynamic and flexible structure, the community benefit programs are designed to respond to assessed needs and are focused on upstream prevention.

PSMC participates in the Medicare and Medicaid programs and is one of the leading providers of Medicaid services in Georgia.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

SERVICE TO THE COMMUNITY, Continued

The following table summarizes the amounts of charges foregone (i.e., contractual adjustments) and estimates the losses incurred by PSMC due to inadequate payments by these programs and for indigent/charity services. This table does not include discounts offered by PSMC under managed care and other agreements:

	<u>Charges Foregone</u>	<u>Estimated Unreimbursed Cost</u>
Medicare	\$ 32,299,000	\$ 20,400,000
Medicaid	19,045,000	12,029,000
Indigent/charity	<u>6,525,000</u>	<u>4,121,000</u>
	\$ <u>57,869,000</u>	\$ <u>36,550,000</u>

The following is a summary of the community benefit activities and health improvement services offered by PSMC and illustrates the activities and donations during fiscal year 2012.

**I. Community Health Improvement Services**

**A. Community Health Education**

*Men's Health Conferences*

PSMC held the 3rd Annual Men's Health Conference on September 17, 2011, that provided health screenings for PSA, cholesterol, blood pressure, hearing and vision, health information, speakers, and fellowship to more than 500 attendees. The health conference programs provide outreach, health screenings, educational programs, and health conferences and events. These programs target men at risk of poor health status. The programs target uninsured or underinsured men without a primary care physician or knowledge of recommended preventive health care services.

*Women's Health Conferences*

PSMC held the 3rd Annual Women's Health Conference on May 19, 2012, that provided health screenings for cholesterol, blood pressure, hearing and vision, health information, speakers, and fellowship to more than 400 attendees. The health conference programs provide outreach, health screenings, educational programs, and health conferences and events. These programs target women at risk of poor health status. The programs target uninsured or underinsured women without a primary care physician or knowledge of recommended preventive health care services.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

SERVICE TO THE COMMUNITY, Continued

---

B. Community Based Clinical Services

Flu Shots

PSMC provides free flu shots to volunteers and employees' family members. In 2012, PSMC administered 121 flu shots at an unreimbursed cost of \$1,000.

School Nurse Program

PSMC places a nurse and two techs in the Sumter County School System. During the 2011/2012 school year, the school nurse program had 14,934 clinic visits and administered 32,380 doses of medication at an unreimbursed cost of \$34,000.

Nurses/Nursing Students

In fiscal year 2012, PSMC provided \$29,000 in clinical supervision and training of 57 nurses.

C. Health Care Support Services

• Indigent Financial Assistance

Patients whose income is below 125% of the Federal Poverty Levels are classified as indigent and receive care at no cost.

• Charity Financial Assistance

Patients whose income level is between 126% - 200% of the Federal Poverty Levels will be classified as charity. These patients will be responsible for a percentage of the Hospital charges. This percentage will be based on calculations using the Federal Poverty Levels that are published in the "Federal Register" each year. If it is determined the patient responsibility will be an undue hardship on the patient/guarantor, these cases will be reviewed on an individual basis with the Phoebe Cares Supervisor for possible catastrophic charity based on sliding scale guidelines.

Continued

PHOEBE SUMTER MEDICAL CENTER, INC.

SERVICE TO THE COMMUNITY, Continued

---

- Catastrophic Financial Assistance

Patients whose income exceeds 200% of the Federal Poverty Levels and whose hospital charges exceed 25% of their annual income, resulting in excessive hardship, are eligible for a discount up to 75% of the patient balance. The patient may pay the remaining balance over 24 months.

During fiscal year 2012, 727 patients were approved for financial assistance.

## II. Subsidized Health Services

### A. Hospital Outpatient Services

#### *Ellaville Primary Medicine Center*

PSMC has a strong commitment to primary care for the Southwest Georgia region. The family medical centers in the surrounding counties are a network of care that serves the entire family for those who reside in Ellaville and Schley County.

#### *Phoebe Specialty Clinics*

- Internal Medicine and Specialty clinics provide primary and consultative medical care of adults, with emphasis on diagnosis, preventive health and continuity of care in both outpatient and inpatient settings. In 2012, these clinics operated at a net loss of \$479,000.
- Maternal/Fetal Medicine program is for high risk mothers and pregnant women who need specialized care. It serves this perinatal region. In 2012, this clinic operated at a net loss of \$223,000.
- Emergency Medicine department had 25,009 visits in 2012 and operated at a net loss of \$49,000.

See independent auditor's report on supplemental information.