

**SOUTHWEST MISSISSIPPI
REGIONAL MEDICAL CENTER**

McComb, Mississippi

Financial Statements

Year Ended September 30, 2016

CONTENTS

Independent Auditor's Report	1 – 3
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Management's Discussion and Analysis	4 – 10
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Financial Statements	
Statement of Net Position	11
Statement of Revenues, Expenses, and Changes in Net Position	12
Statement of Cash Flows	13
Notes to Financial Statements	14 – 36

INDEPENDENT AUDITOR'S REPORT



WM. F. HORNE
& Company, PLLC
CPAs • BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
Southwest Mississippi Regional
Medical Center
McComb, Mississippi

Report on the Financial Statements

We have audited the accompanying financial statements of Southwest Mississippi Regional Medical Center (the "Medical Center"), as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents.

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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *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 financial position of the Medical Center as of September 30, 2016, and the changes in financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 3 to the financial statements, the Medical Center adopted new accounting guidance and implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*, which establishes general principles for measuring fair value and standards of accounting and financial reporting for assets and liabilities measured at fair value. As a result, there is an additional disclosure which provides information regarding the valuation methodologies.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 – 10 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 inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 22, 2017, on our consideration of the Medical Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and 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 Medical Center's internal control over financial reporting and compliance.

Wm. F. White & Co. PLLC

Laurel, Mississippi
February 22, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Management's Discussion and Analysis (Unaudited)

Year Ended September 30, 2016

Our discussion and analysis of Southwest Mississippi Regional Medical Center's (the "Medical Center") annual performance provides an overview of the entity's financial activities for the fiscal year ended September 30, 2016. This information should be used in conjunction with the Medical Center's financial statements, which begin on page 11.

Background and Overview

The Medical Center, located in McComb, Mississippi, was established in 1969 and serves a seven-county area of Mississippi. The Medical Center also draws from two parishes in neighboring eastern Louisiana. According to the most recent Certificate of Needs records, the Medical Center's extended service area is a largely rural population of 170,000 people.

The Medical Center has developed an integrated health system that provides comprehensive, state-of-the-art healthcare to a population that typically would have to travel 60 to 100 miles to Jackson, Mississippi, New Orleans or Baton Rouge, Louisiana for such levels of service.

The Medical Center includes the 160-bed Southwest Mississippi Regional Medical Center with over 1,000 employees and 70 physicians on staff; the Cardiovascular Institute of Mississippi providing comprehensive cardiovascular care, the Mississippi Cancer Institute for the treatment and prevention of cancer; and a home health service serving 17 counties. The Medical Center owns and operates 11 clinics, including rural health clinics, and an outpatient rehabilitation center. The Medical Center also manages and operates Lawrence County Hospital in Monticello, Mississippi. In addition, St. Luke Foundation and its component units provide home health services to clients living in Pike, Amite, Franklin, Copiah, Lawrence, Walthall, Covington, Marion, Lamar, Jeff Davis, Simpson and Smith Counties.

Using This Annual Report

The Medical Center's financial statements consist of three statements – a statement of net position; a statement of revenues, expenses and changes in net position; and a statement of cash flows. These financial statements and related notes provide information about the activities of the Medical Center, including resources held by the Medical Center but restricted for purposes by contributors, grantors, or enabling legislation. The financial statements presented herein also include the activities of its blended component unit. Complete financial statements for the blended component unit can be requested from the Medical Center's chief financial officer.

The statement of net position includes all of the Medical Center's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes and which assets are limited as to use as a result of bond covenants or other restrictions. The makeup, changes thereto and general comments regarding how the changes occurred will be discussed later. The Medical Center's statement of net position indicates a very strong financial position.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Management's Discussion and Analysis (Unaudited)

Year Ended September 30, 2016

The statement of revenues, expenses, and changes in net position reports all of the revenues and expenses for the period. Revenues measure and represent the volume and types of services provided to the Medical Center's customers, the patients we serve. This statement also reflects the costs of providing those services enumerated by the various categories of and types of expenses incurred. This statement further reveals how the Medical Center was able to manage its business to either provide the services at a profit or loss.

The final required statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating activities, noncapital financing activities, capital and related financing activities, and investing activities. The above-mentioned categories specify the cash funding by the Medical Center.

Financial Highlights

Year Ended September 30, 2016

The Medical Center's overall financial position remained strong during the year and had an overall increase in net position of \$237,000.

Positive factors affecting financial results included:

- Disproportionate Share ("DSH") and Upper Payment Limit ("UPL") net revenues were \$9.6 million.
- Electronic Health Record program payments of \$77,000 were recognized.

Negative factors affecting financial results included:

- Payments received from the federal Medicare program continued to be negatively impacted by the federal government's sequestration cuts and other changes mandated by the Affordable Care Act.
- Continuing shift in payment responsibility from third-party payors to patients through higher deductibles and copays.
- An adverse Medicare redetermination decision that resulted in a \$1,888,926 adjustment to Home Health Medicare revenue.

At the end of the 2016 fiscal year, the assets of the Medical Center exceeded liabilities by approximately \$50.4 million. Of this excess amount, approximately \$39.7 million (unrestricted net position) may be used to meet ongoing obligations to the Medical Center's employees, patients and creditors. The Medical Center is self-insured for general and professional liability claims and has established a self-insurance fund in accordance with the requirements of the Mississippi Tort Claims Board. At September 30, 2016, the Medical Center had \$1 million deposited into this restricted account.

Total operating revenue decreased \$1.87 million or 1.3 percent, primarily as a result of the adverse Medicare redetermination decision.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Management's Discussion and Analysis (Unaudited)

Year Ended September 30, 2016

Operating expenses, excluding depreciation and amortization, increased by \$1.94 million, primarily due to the use of certain contract services and increased supply utilization in oncology services. The Medical Center also experienced other less significant increases and decreases in other operating expenses.

Condensed Financial Information

Statements of Net Position

A summary of the Medical Center's Statements of Net Position for September 30, 2016 and 2015 are presented in the following table:

Condensed Statements of Net Position (In Thousands)

	Fiscal Year	
	2016	2015
Current and other assets	\$ 59,360	\$ 58,814
Capital assets	31,771	33,136
Total assets	<u>\$ 91,131</u>	<u>\$ 91,950</u>
Long-term debt	\$ 23,764	\$ 23,090
Other liabilities	16,941	18,672
Total liabilities	<u>\$ 40,705</u>	<u>\$ 41,762</u>
Net investment in capital assets	\$ 8,007	\$ 10,046
Restricted	2,746	2,675
Unrestricted	39,673	37,467
Total net position	<u>\$ 50,426</u>	<u>\$ 50,188</u>

Fiscal Year Ended September 30, 2016

Total assets decreased by approximately \$819,000, primarily due to the Medical Center's normal annual depreciation costs for capital assets offset by capital asset additions in the normal course of business.

Total liabilities decreased by approximately \$1,057,000. This change resulted from net new borrowings of the Medical Center's line of credit, as well as net repayments on capital lease and other obligations.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Management's Discussion and Analysis (Unaudited)

Year Ended September 30, 2016

Summary of Revenue Expenses, and Changes in Net Position

The following table presents a summary of the Medical Center's revenue and expenses for the fiscal years ended September 30, 2016 and 2015:

**Condensed Statements of Revenues, Expenses, and Changes in Net Position
(In Thousands)**

	Fiscal Year	
	2016	2015
Operating revenue		
Net patient service revenue	\$ 139,646	\$ 141,784
Other operating income	1,661	1,392
Total operating income	141,307	143,176
Operating expenses		
Salaries, wages, and benefits	73,641	74,151
Supplies and other operating expenses	59,702	57,254
Depreciation and amortization expense	7,963	9,369
Total operating expenses	141,306	140,774
Income from operations	1	2,402
Nonoperating revenue (expense)	236	(1,015)
Change in net position	\$ 237	\$ 1,387

Operating Revenue**Fiscal Year Ended September 30, 2016**

During fiscal year 2016, the Medical Center derived 99 percent of its total operating revenues from net patient service revenues. Such revenues included revenues from Medicare (50 percent) and Medicaid (35 percent) programs, and patients or their third-party carriers (15 percent), who pay for care in the Medical Center's facilities. Operating revenues are discussed further in the notes to the financial statements.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Management's Discussion and Analysis (Unaudited)

Year Ended September 30, 2016

Operating Results and Financial Performance

The following summarizes the Medical Center's operating results and financial performance between 2016 and 2015:

- Inpatient services declined by less than 1% as a result of continuing regulatory emphasis on outpatient service utilization.
- Gross patient revenues increased by \$14,099,000 or 4 percent and net patient service revenue decreased by \$2,138,000 or 1.5 percent. Revenue deductions for contractual adjustments and bad debt expense increased from 60.0 percent of gross revenue in 2015 to 62.1 percent of gross revenue in 2016, primarily as a result of a Medicare redetermination finding and the effect of the Medical Center's new charity policy being in effect for a full year.
- Salaries and benefits decreased from \$74,151,000 in 2015 to \$73,641,000 in 2016, or .7 percent, primarily as a result of discontinuing certain physician clinic operations.

Capital Assets

The following summarizes the Medical Center's investment in capital assets as of September 30, 2016 and 2015:

Capital Assets (In Thousands)

	Fiscal Year	
	2016	2015
Land	\$ 334	\$ 693
Construction in progress	2,440	655
Land improvements	2,396	2,394
Buildings and improvements	55,784	55,080
Leasehold improvements	976	1,195
Equipment	2,900	2,948
Major moveable equipment	88,747	85,693
Subtotal	153,577	148,658
Less accumulated depreciation	(121,806)	(115,522)
Capital assets, net	\$ 31,771	\$ 33,136

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Management's Discussion and Analysis (Unaudited)

Year Ended September 30, 2016

Fiscal Year Ended September 30, 2016

The change in net capital assets consists of additions of \$7 million, primarily other major moveable equipment, offset by \$8 million of depreciation. The Medical Center had no significant construction projects ongoing at year-end. More detailed information about capital assets is presented in the notes to the financial statements.

Long-Term Debt

The following summarizes the Medical Center's long-term debt as of September 30, 2016 and 2015:

	Long-term Debt (In Thousands)	
	Fiscal Year	
	2016	2015
Bonds payable	\$ 12,008	\$ 12,793
Notes payable	6,339	4,520
Capital lease obligations	5,417	5,777
Long-term debt	<u>\$ 23,764</u>	<u>\$ 23,090</u>

Fiscal Year Ended September 30, 2016

During 2015, the Medical Center paid down \$5.8 million in long-term debt principal. The Medical Center added \$3.6 million in notes payable and \$2.8 million in new capital lease obligations related to capital additions. More detailed information about the long-term debt is presented in the notes to the financial statements.

Economic Factors and Next Year's Budget

While the annual budget of the Medical Center is not presented within these financial statements, the Medical Center's Board and management considered many factors when setting the fiscal year 2017 budget. While the financial outlook for the Medical Center is improving, the primary importance in setting the 2017 budget is the status of the economy and the healthcare environment, which takes into account market forces and environmental factors such as:

- Medicare reimbursement and regulatory changes.
- Medicaid reimbursement changes, as well as the continuation at the current level of the Disproportionate Share and Mississippi Hospital Access Payment programs.
- Increased regulatory requirements for enhanced information technology.
- Ability to reverse the negative trends experienced in collections due to the system conversions.
- Increased number of uninsured and working poor.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Management's Discussion and Analysis (Unaudited)

Year Ended September 30, 2016

- Ability to manage the increase in patient portions of billings for services seen in the newer high deductible insurance plans.
- Ongoing competition for services.
- Workforce shortages primarily in nursing and other clinically skilled positions.
- Rising cost of supplies, including pharmaceuticals.
- Ability to continue recruiting medical staff physicians.

Contacting Medical Center's Financial Management

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Medical Center's finances. If you have any questions about this report or need additional financial information, please contact the Chief Financial Officer, Southwest Mississippi Regional Medical Center, 215 Marion Avenue, McComb, Mississippi 39648.

BASIC FINANCIAL STATEMENTS

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Statement of Net Position

September 30, 2016

ASSETS

Current assets

Cash and cash equivalents	\$ 4,111,327
Investments	9,415,536
Restricted investments	1,018,711
Accounts receivable, patients, net of allowance for uncollectible accounts of \$30,175,059	31,376,494
Other receivables	2,220,486
Inventories	5,431,030
Estimated third-party payor settlements	217,759
Prepaid expenses and other current assets	<u>1,403,908</u>

Total current assets 55,195,251

Noncurrent assets

Restricted cash and cash equivalents	762,435
Restricted investments	2,328,414
Investments	522,845

Capital assets

Capital assets not being depreciated	2,774,270
Capital assets, net of accumulated depreciation	<u>28,996,357</u>

Capital assets, net 31,770,627

Other noncurrent assets

Due from physicians	210,162
Other assets	<u>341,514</u>

Total noncurrent assets 35,935,997

Total assets 91,131,248

LIABILITIES

Current liabilities

Accounts payable	\$ 5,799,436
Line of Credit	4,410,049
Salaries and payroll taxes payable	1,842,679
Bond interest payable from restricted assets	344,438
Other accrued expenses	404,967
Accrued compensated absences	2,474,262
Current maturities of capital lease obligations	2,408,281
Current maturities of notes payable	2,788,853
Current maturities of bonds payable from restricted assets	<u>835,000</u>

Total current liabilities 21,307,965

Long-term liabilities

Estimated claims payable	1,665,632
Capital lease obligations, less current maturities	3,008,720
Notes payable, less current maturities	3,550,121
Bonds payable, less current maturities	<u>11,173,049</u>

Total long-term liabilities 19,397,522

Total liabilities 40,705,487

NET POSITION

Net investment in capital assets	8,006,603
Restricted for debt service	2,746,411
Unrestricted	<u>39,672,747</u>

Total net position \$ 50,425,761

See accompanying notes.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Statement of Revenues, Expenses, and Changes in Net Position

Year Ended September 30, 2016

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Operating revenue	
Patient service revenue, net of contractual allowances and discounts	\$ 159,403,731
Provision for bad debts	<u>(19,757,650)</u>
Net patient service revenue less provision for bad debts	139,646,081
Other operating revenue	<u>1,660,738</u>
Total operating revenue	<u>141,306,819</u>
Operating expenses	
Salaries and wages	64,370,254
Professional fees	8,220,079
Employee benefits	9,270,891
Supplies	27,040,326
Maintenance and repairs	8,547,354
Other operating expense	15,893,716
Depreciation and amortization	7,963,292
Total operating expenses	<u>141,305,912</u>
Operating income	<u>907</u>
Nonoperating revenue (expenses)	
Grants and contributions	26,800
Investment income	248,709
Interest expense	(1,051,344)
Loss on disposal of capital assets	(42,563)
Other income	1,054,862
Total nonoperating revenue (expenses)	<u>236,464</u>
Change in net position	<u>237,371</u>
Net position, beginning of year	50,188,390
Net position, end of year	<u>\$ 50,425,761</u>

See accompanying notes.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTERStatement of Cash Flows
Year Ended September 30, 2016

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Cash flows from operating activities	
Cash from and on behalf of patients	\$ 135,300,015
Cash paid to employees	(74,446,190)
Cash paid to suppliers	(60,913,078)
Other receipts and payments, net	<u>1,660,738</u>
Net cash provided by operating activities	<u>1,601,485</u>
Cash flows from noncapital financing activities	
Advances on line of credit	7,535,049
Payments on line of credit	(3,125,000)
Other receipts	54,862
Noncapital grants and contributions	<u>26,800</u>
Net cash provided by noncapital financing activities	<u>4,491,711</u>
Cash flows from capital and related financing activities	
Principal paid on capital lease obligations	(3,165,068)
Principal paid on notes payable	(1,810,248)
Principal paid on bonds payable	(795,000)
Proceeds from sale of capital assets	540,793
Purchase of capital assets	(4,366,595)
Interest paid on long-term debt	<u>(1,072,731)</u>
Net cash (used) by capital and related financing activities	<u>(10,668,849)</u>
Cash flows from investing activities	
Purchases of investments	(6,907,668)
Sales of investments	6,825,000
Interest on investments	<u>203,374</u>
Net cash provided by investing activities	<u>120,706</u>
Net decrease in cash and cash equivalents	(4,454,947)
Cash and cash equivalents, beginning of year	<u>9,328,709</u>
Cash and cash equivalents, end of year	<u><u>\$ 4,873,762</u></u>

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Reconciliation of operating income to net cash provided by operating activities	
Income from operations	\$ 907
Adjustments to reconcile income from operations to net cash provided by operating activities	
Depreciation and amortization	7,963,292
Changes in assets and liabilities	
(Increase) decrease in assets	
Patient accounts receivable	(4,518,367)
Other receivables	(167,147)
Inventories	(688,176)
Prepaid expenses and other current assets	526,762
Estimated third-party payor settlements	(47,674)
Other noncurrent assets	21,409
Increase (decrease) in liabilities	
Accounts payable	(1,403,888)
Salaries and payroll taxes payable	(1,078,077)
Accrued compensated absences	7,537
Other accrued expenses	984,907
	<hr/>
Net cash provided by operating activities	<u>\$ 1,601,485</u>
Reconciliation of cash and cash equivalents to the statement of net position	
Cash and cash equivalents included in current assets	\$ 4,111,327
Restricted cash and cash equivalents included in noncurrent assets	762,435
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Total	<u>\$ 4,873,762</u>
Supplemental disclosures of noncash financing activities	
Capital assets financed through capital lease obligations	<u>\$ 2,805,309</u>

See accompanying notes.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

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

Nature of Operations and Reporting Entity

Southwest Mississippi Regional Medical Center (the "Medical Center") consists of an acute-care hospital and related outpatient facilities jointly owned by the City of McComb, Mississippi, Amite County, Mississippi and Pike County, Mississippi. The Medical Center operates in the form of a government authority, governed by a Board of Trustees pursuant to Sections 41-13-15 et seq. of Mississippi Code of 1972, as amended, consisting of members from the city and counties. It is an independent enterprise held and operated separate and apart from all other assets and activities of the city and counties. It is not a taxable entity and does not file an income tax return.

The Medical Center provides inpatient, outpatient, rehabilitation and emergency care services primarily for residents of the City of McComb, Mississippi, Amite County, Mississippi, Lawrence County, Mississippi and Pike County, Mississippi and the surrounding area. Admitting physicians are primarily practitioners in the same area.

The Medical Center operates a critical access facility in Monticello, Mississippi. This division of the Medical Center offers short-term acute care and swing bed services to patients. To operate this facility, the Medical Center entered into a lease with the Lawrence County Board of Supervisors to lease the Lawrence County Hospital (the "Hospital"). The lease was renewed in September 2016 for an additional five-year period. The lease calls for annual payments of approximately \$130,000. The Medical Center has the right to terminate the lease in the event that the Medical Center is unable to maintain the Hospital's designation as a critical access hospital or if the hospital is unable to maintain its accreditation. In addition, if the Medical Center determines, in its sole discretion, that the healthcare regulatory environment has changed to the extent that the provision of health services by the Medical Center at the Hospital has become cost prohibitive or otherwise not financially feasible, the Medical Center can terminate the lease with 365 days prior written notice.

The basic financial statements of the Medical Center have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The GASB has issued a codification of governmental accounting and financial reporting standards. This codification and subsequent GASB pronouncements are recognized GAAP for governments.

Following this section, are the significant accounting policies used by the Medical Center in preparing and presenting its financial statements.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Reporting Entity

The accompanying financial statements present the Medical Center and its blended component unit, The St. Luke Foundation (the "Foundation"), an entity for which the Medical Center is considered to be financially accountable. Blended component units are, in substance, part of the reporting entity's operations, even though they are legally separate entities. The Foundation, a not-for-profit organization, was created and operated exclusively for the purpose of owning and operating St. Luke Home Health Services, LLC for the Medical Center. The Medical Center is the sole member of the Foundation. The Foundation is included as a blended component unit in the financial statements.

Included within the reporting entity of the Foundation is St. Luke Home Health Services, LLC, which provides home health care to the Southwest Mississippi community; and Doctor's Urgent Care, LLC, which provides clinical services to the Southwest Mississippi community. The Foundation is the sole member of both of these entities.

Separate audited financial statements are issued for the Foundation. These financial statements may be obtained through a written request to the Chief Financial Officer at Southwest Mississippi Regional Medical Center, 215 Marion Avenue, McComb, Mississippi 39648.

All significant intercompany balances and transactions have been eliminated.

Basis of Accounting

Basis of accounting refers to when revenues, expenses and related assets and liabilities are recognized in the accounts and reported in the financial statements. The Medical Center uses the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, substantially all revenues and expenses are subject to accrual. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like activities are generally recognized when the exchange takes place. Revenues, expenses, gains, losses, assets, and liabilities resulting from non-exchange activities are generally recognized when all applicable eligibility requirements, including timing requirements, are met.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires that management make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses, as well as 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. Significant estimates and assumptions are used for, but are not limited to, contractual allowances for revenue adjustments, allowance for doubtful accounts, depreciable and economic lives of capital assets, and fair value of leased assets.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

The accounting estimates used in the preparation of the financial statements will change as new events occur, as more experience is acquired and as additional information is obtained. Future events and their effects cannot be predicted with certainty; accordingly, accounting estimates require the exercise of judgment. In particular, laws and regulations governing Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates related to these programs will change by a material amount in the near term.

Cash and Cash Equivalents

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

Investments

Investments consist of money market investments, the Mississippi Hospital Association (MHA) investment pool, U.S. Treasury obligations, and an investment in a real estate limited liability company (LLC) reported by the Foundation. Money market investments are reported at amortized cost which approximates fair value, investments in the MHA pool are reported at net asset value per share which approximates fair value, U.S. Treasury obligations are measured at fair value based on quoted prices for similar assets in active markets, and the investment in the real estate LLC is reported at fair value based on the estimated fair value of the underlying assets of the LLC as of September 30, 2016. Investment income on investments, including realized and unrealized gains and losses, is reported in the statement of revenues, expenses, and changes in net position as nonoperating revenues (expenses).

The MHA investment pool is authorized to invest in bonds or other direct obligations of the U.S., the State of Mississippi, or of any approved county, school district or municipality of the state; obligations issued or guaranteed in full by the U.S. which are subject to a repurchase agreement with a financial institution certified as a qualified depository; U.S. Government agency instruments which are fully guaranteed by the U.S. Government; any open-end or closed-end management type investment company (money market and mutual funds) or trust fund that invests in direct obligations of the U.S. or repurchase agreements that are fully collateralized by these direct obligations; and any commercial paper, corporate notes and bonds that have an "A" rating or better.

The MHA investment pool is an investment program developed for member hospitals of the MHA. The investments are managed by an investment advisor registered with the Securities and Exchange Commission. The investment advisor is approved by the MHA board of trustees.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Restricted Cash and Investments

Restricted cash and investments consist of assets held by the Medical Center in reserve accounts subject to a bond or other borrowing agreement and funds held under self-insurance arrangements.

Patient Receivables

Patient receivables are reported at estimated net realizable amounts from federal and state agencies (under the Medicare and Medicaid programs), managed health plans, commercial insurance companies, workers' compensation, employers and patients, after deduction of allowances for estimated uncollectible amounts.

The allowance for doubtful accounts is based on historical losses and analysis of currently outstanding amounts. This account is generally increased by charges to a provision for bad debts and decreased by write-offs of accounts determined by management to be uncollectible.

Inventories

Inventories, consisting primarily of pharmaceuticals and medical supplies, are stated at the lower of cost or market based on the first-in, first-out method, whichever is lower.

Prepaid Expenses

Prepaid expenses are amortized over the estimated period of future benefit, generally on a straight-line basis.

Capital Assets

Capital asset 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. Assets under capital lease obligations are recorded at the lower of the present value of the minimum lease payments or the fair value of the leased asset, and are depreciated on the straight-line method over the shorter period of the lease term or the estimated useful life of the assets. Contributed property and equipment is recorded at acquisition value (an entry price) at the date of donation.

Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. Accordingly, the total amount of interest that was capitalized as of September 30, 2016 was \$20,139.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

In accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Reserve* ("GASB 42"), management evaluates assets for potential impairment when a significant, unexpected decline in the service utility of capital assets occurs.

Useful lives for major asset classes follows:

	Year
Land improvements	5 - 20
Buildings and improvements	5 - 40
Fixed equipment	5 - 25
Major moveable equipment	5 - 20

Cost of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Premiums or discounts incurred in connection with the issuance of bonds and indentures are amortized over the life of the obligations using the effective interest method, and the unamortized amount is included in the balance of the outstanding debt.

Due from Physicians

The Medical Center advances funds to physicians in connection with agreements with the physicians to establish their practices in the McComb, Mississippi area. The amounts advanced are to be repaid over a stipulated period in the agreement. The Medical Center will accept, in lieu of the monthly payment by the physician, continuous service by the physician over the repayment period. Repayment in the form of services provided is recorded as an other operating expense in the statement of revenues, expenses and changes in net position.

Estimated Malpractice Costs

The Medical Center considers the need for recording a liability for malpractice claims. When determined to be necessary, the provision for estimated malpractice claims and the cost associated with litigation and settlement includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Compensated Absences

Employees employed prior to August 1, 2014 are granted both vacation and sick leave. Accumulated vacation pay is accrued at the balance sheet date because it is payable upon termination of employment. Sick pay accrues but is not reflected as a liability because it is not payable upon termination of employment.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Paid time off (“PTO”) is provided to all full-time employees who become employed on or after August 1, 2014. Accumulated PTO is accrued at the balance sheet date since it is probable that the Medical Center will compensate the employees for the benefits through paid time off.

Net position

Net position of the Medical Center is classified in three components: (1) Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. (2) Restricted expendable net position must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center, including amounts deposited with trustees as required by revenue bond indentures. (3) Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets or restricted.

When both restricted and unrestricted resources are available to finance a particular program, it is the Medical Center's policy to use the restricted resources before using the unrestricted resources.

Operating Revenues and Expenses

The Medical Center's statement of revenues, expenses and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is the Medical Center's principal activity. Investment income, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

Net Patient Service Revenue

Patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered and include estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are considered in the recognition and accrual of revenue on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

The primary third-party programs include Medicare and Medicaid, which account for a significant amount of the Medical Center's revenue. The laws and regulations under which Medicare and Medicaid programs operate are complex, and subject to interpretation and frequent changes. As part of operating under these programs, there is a possibility that government authorities may review the Medical Center's compliance with these laws and regulations.

Although no assurance can be given, management believes it has complied with the requirements of these programs.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)

Charity Care

The Medical Center provides medical care without charge or at a reduced charge to patients who meet certain criteria under its charity care policy. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, these charges are not reported as revenue.

Grants and Contributions

From time-to-time, the Medical Center receives grants from other governmental entities 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 are met. Grants and contributions may be restricted either for specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported as capital contributions and grants.

Note 2. Bank Deposits and Investments

Bank Deposits

The collateral for public entity deposits in financial institutions are held in the name of the State Treasurer under a program established by the Mississippi State Legislature and is governed by Section 27-105-5 Miss. Code Ann. (1972). Under this program, the entity's funds are protected through a collateral pool administered by the State Treasurer. Financial institutions holding deposits of public funds must pledge securities as collateral against those deposits. In the event of failure of a financial institution, securities pledged by that institution would be liquidated by the State Treasurer to replace the public deposits not covered by the Federal Depository Insurance Corporation ("FDIC"). All deposits with financial institutions must be collateralized in an amount equal to 105 percent of uninsured deposits. At September 30, 2016, the Medical Center had \$1,009,467 in bank deposits held in a financial institution that is part of this program.

Custodial Credit Risk – Deposits. Custodial credit risk is the risk that, in the event of a bank failure, the Medical Center's deposits might not be recovered. The Hospital has a deposit policy for custodial credit risk that requires deposits to be part of the collateral pool administered by the State, as noted above. However, cash deposits with The St. Luke Foundation are not part of this pool and are exposed to custodial credit risk. Uninsured and uncollateralized cash deposits with financial institutions totaled \$2,688,169 as September 30, 2016.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS**Note 2. Bank Deposits and Investments (Continued)**

The carrying amounts of deposits and investments are as follows at September 30, 2016:

Cash and cash equivalents	\$ 4,873,762
MHA Investment Pool	6,298,679
U.S. Treasury bills	6,463,982
Other investments	522,845
Total	<u>\$ 18,159,268</u>

These deposits and investments are reported on the statement of net position at September 30, 2016 as follows:

Cash and cash equivalents	\$ 4,111,327
Investments	9,415,536
Restricted investments	1,018,711
Noncurrent restricted cash and cash equivalents	762,435
Noncurrent investments	522,845
Total	<u>\$ 15,830,854</u>

Investments

Mississippi Code 27-105-365 restricts the authorized investments of the Medical Center to obligations of the U.S. Treasury, agencies, and instrumentalities of the United States, certain open-end and closed-end management-type investment companies and trusts, and certain other trusts consisting of pooled or commingled funds of other hospitals.

The Medical Center's investments consist of the following at September 30, 2016:

	Value	Percentage	Maturity	Interest Rate	Rating
MHA Intermediate Duration Trust	\$ 4,489,827	33.80%	4.3 years	N/A	AA
MHA Short Duration Trust	1,808,852	13.62%	2.3 years	N/A	AA
U.S. Treasury bills	6,463,982	48.65%	< 1 year	.57%-76%	AA+
Other investments	522,845	3.93%	N/A	N/A	N/A
Total	<u>\$ 13,285,506</u>	<u>100.00%</u>			

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 2. Bank Deposits and Investments (Continued)

Other investments consist of a 16.67 percent ownership interest in Medical Arts Building, LLC held by the Foundation.

At September 30, 2016, funds in the amount \$1,018,711, in MHA Pool A were restricted for purposes of self-insurance arrangements and were reported as restricted investments in the statement of net position.

In addition, various sinking funds were established in accordance with requirements of the indentures related to the Series 2003 Bonds discussed in Note 5. Following is a summary of the noncurrent restricted cash, cash equivalents, and investments for bonds at September 30:

Reserve fund	\$ 2,328,414
Principal fund	418,302
Interest fund	344,133
	<hr/>
Total	\$ 3,090,849

Interest Rate Risk - The Medical Center does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. However, the Medical Center limits interest rate risk by attempting to match investment maturities with known cash needs and anticipated cash flow requirements.

Concentration of Credit Risk - The Medical Center has not established asset allocation limits for their investment portfolio to reduce concentrations of credit risk. However, Mississippi Code 27-105-365 limits the amount of investments in U.S. government agency and instrumentalities to 50 percent and the amount of investments in open-end and closed-end management-type investment companies and trusts to 20 percent for all monies invested with maturities of 30 days or longer.

Note 3. Fair Value Disclosures

As of October 1, 2015, the Medical Center adopted new accounting guidance and implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*, which establishes general principles for measuring fair value and standards of accounting and financial reporting for assets and liabilities measured at fair value.

Under the GASB's authoritative guidance on fair value measurements, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The guidance establishes a hierarchy of inputs to valuation techniques used to measure fair value into three levels.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 3. Fair Value Disclosures (Continued)

- Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Medical Center has the ability to access.
- Level 2 - Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices 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 estimated fair values of the Medical Center's short-term financial instruments including cash, cash equivalents, accounts receivable, and accounts payable arising in the ordinary course of business, approximate their individual carrying amounts due to the relatively short period of time between their origination and expected realization. For liabilities such as long-term debt not accounted for at fair value and without quoted market prices, fair value is based upon estimated cash flows adjusted for credit risk which are discounted using an interest rate appropriate for the maturity of the applicable debt.

Following is a description of the valuation methodologies used for investments measured at fair value.

- *MHA Investment Pool* – Valued at the net asset value of shares held by the investment pool.
- *Treasury Bills* – Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities with similar credit ratings.
- *Investment in Medical Arts Buildings, LLC* – Valued based on the estimated fair value of the underlying assets and liabilities of the LLC as of September 30, 2016. There was no change in the fair value reported for this investment from September 30, 2015 to September 30, 2016.

	Fair Value	Level 1	Level 2	Level 3
U.S. Treasury bills	\$ 6,463,982	\$ -	\$ 6,463,982	\$ -
MHA Investment Pool	6,298,679	-	6,298,679	-
Investment in Medical Arts Building, LLC	522,845	-	-	522,845
Total	<u>\$ 13,285,506</u>	<u>\$ -</u>	<u>\$ 12,762,661</u>	<u>\$ 522,845</u>

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 4. Capital Assets

Capital assets activity for the year ended September 30, 2016 was as follows:

	Beginning	Additions	Retirements	Ending
Capital assets not being depreciated				
Land	\$ 692,608	\$ -	\$ (358,209)	\$ 334,399
Construction in progress	654,660	2,163,634	(378,423)	2,439,871
Total capital assets not being depreciated	<u>1,347,268</u>	<u>2,163,634</u>	<u>(736,632)</u>	<u>2,774,270</u>
Capital assets being depreciated				
Land improvements	2,393,878	1,724	-	2,395,602
Building and improvements	55,080,136	726,067	(21,893)	55,784,310
Leasehold improvements	1,194,795	223,292	(442,227)	975,860
Equipment	2,948,113	35,712	(83,818)	2,900,007
Major moveable equipment	85,693,031	4,399,898	(1,345,909)	88,747,020
Total capital assets being depreciated	<u>147,309,953</u>	<u>5,386,693</u>	<u>(1,893,847)</u>	<u>150,802,799</u>
Less accumulated depreciation				
Land improvements	(2,225,682)	(67,479)		(2,293,161)
Building and improvements	(37,803,948)	(1,246,169)	17,881	(39,032,236)
Leasehold improvements	(819,085)	(51,398)	233,236	(637,247)
Equipment	(2,598,055)	(152,424)	75,513	(2,674,966)
Major moveable equipment	(72,074,772)	(6,436,317)	1,342,257	(77,168,832)
Total accumulated depreciation	<u>(115,521,542)</u>	<u>(7,953,787)</u>	<u>1,668,887</u>	<u>(121,806,442)</u>
Capital assets being depreciated, net	<u>31,788,411</u>	<u>(2,567,094)</u>	<u>(224,960)</u>	<u>28,996,357</u>
Total capital assets, net	<u>\$ 33,135,679</u>	<u>\$ (403,460)</u>	<u>\$ (961,592)</u>	<u>\$ 31,770,627</u>

Depreciation expense for the year ended 2016 totaled \$7,953,787. The Medical Center had \$49,305 in commitments on construction contracts at September 30, 2016.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Liabilities

A summary of long-term debt and capital lease obligations at September 30 follows:

Mississippi Hospital Equipment and Facilities Authority Hospital Refunding and Improvement Revenue Bonds, Series 2003, consisting of \$9,385,000 of serial bonds and \$12,370,000 of term bonds with annual sinking fund requirements ranging from \$1,301,250 to \$1,821,900, at annual interest rates ranging from 2.30 percent to 5.75 percent, maturing April 1, 2029, secured by a pledge of future revenues.	\$ 12,008,049
Note payable to Trustmark Bank, with monthly principal and interest payments of \$9,117, at an annual interest rate of 3.58 percent, maturing in January 2018, unsecured.	142,200
Note payable to State Bank, with annual principal and interest payments of \$71,890, at an annual interest rate of 3.95 percent, maturing in December 2018, collateralized by real estate.	199,354
Construction Revenue Note, Series 2007, payable to Trustmark Bank, principal and interest payable in equal monthly installments of \$40,850 at an annual interest rate of 3.71 percent, maturing in September 2018, collateralized by future revenue flows.	2,617,711
Note payable to McKesson Technologies, Inc., with monthly principal only payments of \$41,666, maturing in March 2021, unsecured.	3,379,709
Capital lease obligations, at interest rates ranging from 0.76 percent to 10.32 percent, with lease terms from 27 months to 72 months, collateralized by leased equipment.	<u>5,417,001</u>
Total	23,764,024
Less current maturities	<u>(6,032,134)</u>
Long-term debt, net of current maturities	<u><u>\$ 17,731,890</u></u>

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Liabilities (Continued)

In connection with the aforementioned revenue note payable and bonds payable, the Medical Center has agreed to certain covenants as follows. The Medical Center's debt service coverage ratio must be at least 1.35:1 and it must maintain a minimum of 60 days cash on hand, measured as of March 31 and September 30 of each fiscal year. The Medical Center was in compliance with the debt service coverage ratio for the year ended September 30, 2016; however, the Medical Center was not in compliance with the day's cash on hand covenant. The debt agreement stipulates that failure to comply with these debt covenants shall not constitute an event of default if the Medical Center retains a consultant to advise on its financial operations and implements the suggestions provided by the consultant. Management believes that it has taken appropriate action to meet the requirements set forth by the lender.

Scheduled debt service payments on long-term debt, excluding capital lease obligations are as follows:

Year Ended September 30,	Long-Term Debt	
	Principal	Interest
2017	\$ 3,623,853	\$ 752,038
2018	2,061,344	671,255
2019	1,377,635	608,689
2020	1,351,035	564,671
2021	1,778,294	519,283
2022 - 2026	4,776,813	1,844,078
2027 - 2029	3,500,000	410,263
Total	18,468,974	\$ 5,370,277
Less unamortized discount	(121,951)	
Total	\$ 18,347,023	

Capital Lease Obligations

The Medical Center has entered into lease agreements for financing the acquisition of various major moveable equipment. These agreements qualify as capital leases for accounting purposes, and, therefore, are recorded at the present value of future minimum lease payments as of the lease inception date. Lease terms range from twenty-seven months to seventy-two months.

Major moveable equipment under capital leases included in capital assets at September 30, 2016 includes the following:

Major moveable equipment	\$ 23,790,272
Less accumulated depreciation	(18,502,292)
Net major moveable equipment	\$ 5,287,980

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Liabilities (Continued)

The future minimum lease obligations and the net present value of these minimum lease payments as of September 30, 2016, were as follows:

Year Ending September 30,

2017	\$	2,518,154
2018		1,567,445
2019		799,789
2020		571,556
2021		146,993
Total minimum lease payments		<u>5,603,937</u>
Less amount representing interest		<u>(186,936)</u>
Present value of minimum lease payments	\$	<u><u>5,417,001</u></u>

Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended September 30, 2016 are as follows:

	Beginning Balance	Additions	Retirements	Ending Balance	Amounts Due Within One Year
Revenue bonds	\$ 12,925,000	\$ -	\$ (795,000)	\$ 12,130,000	\$ 835,000
Less discount on bonds	(131,643)	-	9,692	(121,951)	-
Revenue bonds payable	<u>12,793,357</u>	-	(785,308)	12,008,049	835,000
Notes payable	4,519,513	3,629,709	(1,810,248)	6,338,974	2,788,853
Capital lease obligations	5,776,760	2,805,309	(3,165,068)	5,417,001	2,408,281
Estimated claims payable	1,064,891	925,741	(325,000)	1,665,632	-
Total long-term debt	<u>\$ 24,154,521</u>	<u>\$ 7,360,759</u>	<u>\$ (6,085,624)</u>	<u>\$ 25,429,656</u>	<u>\$ 6,032,134</u>

Note 6. Revolving Line of Credit Note

During 2016, the Foundation renewed the revolving credit note with Regions Bank that is secured by investments and real estate. The line matures July 2017 and bears interest due in monthly installments at the one-month LIBOR rate plus 2.25 percent. The interest rate at September 30, 2016 was 2.77 percent. The line has a maximum availability of \$6,000,000 of which \$1,589,951 was available at September 30, 2016.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 6. Revolving Line of Credit Note (Continued)

Activity for the year ended September 30, 2016 was as follows:

Beginning balance	\$ -
Additions	7,535,049
Reductions	<u>(3,125,000)</u>
Ending balance	<u>\$ 4,410,049</u>

Note 7. Retirement Plans

Defined Contribution Plan

The Medical Center contributes to the Southwest Mississippi Regional Medical Center Retirement Matching Plan (the "Plan"), a single-employer 403(b) defined contribution plan, for the benefit of its employees. The Plan is administered by the Variable Annuity Life Insurance Company ("VALIC"). The Plan provides retirement and disability benefits to Plan members and death benefits to beneficiaries of Plan members. Under provisions of the Plan, all employees with one year of service, and who are at least 23 years old, are eligible to participate. Plan provisions and Medical Center contributions are amended by the Board of Trustees. The Medical Center's contribution to the Plan for the year ended September 30, 2016 was \$833,915.

Employees must contribute to the Plan in order to receive any matching contributions from the Medical Center. Employees are permitted to make contributions up to applicable Internal Revenue Code limits. The Medical Center is required to contribute 50 percent of a participant's elective deferral contributions up to 4.00 percent of a participant's compensation.

Employees are immediately vested in their own contributions and earnings on those contributions. Employees become 100 percent vested in Medical Center contributions and earnings on Medical Center contributions after the completion of five years of creditable service. Non-vested contributions are forfeited upon termination of employment and such forfeitures are used to reduce future Medical Center contributions. For the year ended September 30, 2016, forfeitures reduced the Medical Center's contribution expense by \$2,044.

All required contributions were made to the Plan during the year and the Medical Center's liability to the Plan at September 30, 2016 was \$192,551.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 8. Insurance Programs

Risk Management

The Medical Center 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 and accident benefits. Commercial insurance coverage is purchased for most of these risks. However, certain general and professional liability risks are self-funded as further explained below. There were no settlements in excess of the insurance coverage in any of the three prior fiscal years.

Self-Funded Professional Liability and General Liability

The Medical Center established a self-insurance program for professional and general liability exposure, effective February 1, 2003, in accordance with the provisions set forth in the Mississippi Tort Claims Act ("MTCA"). MTCA provides a cap on the amount of damages recoverable against government entities, including governmental hospitals. For claims arising from events occurring on or after July 1, 2001, the amount recoverable is the greater of \$500,000 or the amount of liability insurance coverage that has been retained. Effective December 20, 2006 the Medical Center purchased an annual aggregated stop-loss insurance policy. The aggregate stop-loss coverage will "cap" the self-insured plan's exposure for the plan/policy year.

Payments under the aggregate stop-loss are in accordance with the Tort Act provisions and are limited to \$500,000 per claim (indemnity plus expense) within annual aggregate of \$5 million for all claims.

Effective March 22, 2011 the Medical Center purchased an insurance policy for its general liability exposure only. The policy's per occurrence limit of the coverage is \$500,000 with a \$10,000 deductible per occurrence. This policy has a retroactive date of December 20, 2006.

Consistent with these insurance program changes (and in accordance with the process described below), the Medical Center recorded an accrual for self-insured losses totaling \$1,665,632 at September 30, 2016. The future assertion of claims for occurrences prior to year-end is reasonably possible and may occur; however, management does not anticipate any material impact on the financial statements.

Incurred losses identified through the Medical Center incident reporting system and incurred but not reported losses are accrued based on estimates that incorporate the Medical Center's current inventory of reported claims and historical experiences, as well as considerations such as the nature of each claim or incident, relevant trend factors and advice from consulting actuaries. The Medical Center has established a self-insurance trust fund for payment of liability claims and makes deposits to the fund in amounts determined by the consulting actuaries.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 8. Insurance Programs (Continued)

Changes in the Medical Center's insurance claims liability amount, including related legal fees, for the year 2016 and 2015 were as follows:

	2016	2015
Claims liability, beginning of year	\$ 1,064,891	\$ 1,069,384
Current year claims and changes in estimates	925,741	395,507
Claims payments	(325,000)	(400,000)
Claims liability, end of year	<u>\$ 1,665,632</u>	<u>\$ 1,064,891</u>

Note 9. Net Position – Net Investment in Capital Assets

The portion of net position classified as net investment in capital assets is as follows at September 30, 2016:

Capital assets	\$ 153,577,069
Less accumulated depreciation	(121,806,442)
Less debt outstanding related to capital assets	<u>(23,764,024)</u>
Net investment in capital assets	<u>\$ 8,006,603</u>

Note 10. Concentration of Credit Risk

The Medical Center grants credit without collateral to its patients, most of who are local residents and are insured under third-party payors agreements. The percentage mix of net accounts receivable from patients and major third-party payors at September 30, 2016 was as follows:

Patients	47%
Medicare	29%
Commercial insurance	10%
Medicaid	8%
Other	6%
	<u>100%</u>

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 11. Patient Service Revenue

The Medical Center has agreements with governmental and other third-party payors that provide for payments to the Medical Center for services rendered at amounts different from its established rates. Patient revenue is reported net of contractual adjustments arising from these third-party arrangements as well as net of provisions for uncollectible accounts. A summary of the payment arrangements with major third-party payors follows below.

Medicare

Inpatient acute rehabilitation, psychiatric services, and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or occurrence. These rates vary according to patient classification systems that are based on clinical, diagnostic and other factors. Certain outpatient services related to Medicare beneficiaries are reimbursed based upon fee basis, depending on the service. The Medical Center is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary.

Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed based upon prospective reimbursement methodologies established by the State of Mississippi. The Medical Center is reimbursed at a tentative prospective rate which is adjusted annually based on the annual cost reports as submitted by the Medical Center and audits by the Medicaid fiscal intermediary.

The Medical Center participates in the Mississippi Intergovernmental Transfer Program as a Medicaid Disproportionate Share Hospital ("DSH"), the Medicaid Upper Payment Limit Program ("UPL"), and in the Mississippi Hospital Access Payment ("MHAP") program. Under these programs the Medical Center receives enhanced reimbursement through a matching mechanism. For the fiscal year ended September 30, 2016, the Medical Center reported approximately \$6,681,000, in enhanced reimbursement through the DSH program. DSH amounts are shown as a reduction of contractual adjustments with related assessments of approximately \$557,000.

Beginning July 1, 2015, UPL payments were phased out and the Division of Medicaid ("DOM") implemented the MHAP program in its place. The MHAP program is administered by the DOM through the MississippiCAN coordinated care organizations ("CCO"). The CCO's subcontract with hospitals throughout the state for distribution of the MHAP for the purpose of protecting patient access to hospital care.

The MHAP program began December 1, 2015 and the MHAP payments are distributed in equal monthly installments and the associated tax are collected in quarterly installments. For the fiscal year ended September 30, 2016, the Medical Center reported approximately \$7,926,000 in enhanced reimbursements, and assessments of approximately \$3,509,000 through the MHAP program. MHAP amounts are shown as a reduction of contractual adjustments.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 11. Patient Service Revenue (Continued)

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. For the year ended September 30, 2016, net patient revenue increased approximately \$970,000, due to prior year retroactive adjustments in excess of amounts previously estimated. As of September 30, 2016, the Medical Center's Medicare cost reports have been settled through September 30, 2013.

Other

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

A summary of gross and net patient service revenue for the year ended September 30, 2016 follows:

Gross patient service revenue	\$ 359,595,022
Less provisions for	
Bad debts	(19,757,650)
Contractual adjustments under third-party reimbursement programs	<u>(200,191,291)</u>
Net patient service revenue	<u>\$ 139,646,081</u>

A summary of the changes in the allowance for uncollectible accounts for the year ended September 30, 2016 follows:

Allowance for uncollectible accounts, beginning	\$ 32,466,370
Self-pay write-offs	(22,048,961)
Change in estimate	<u>19,757,650</u>
Allowance for uncollectible accounts, ending	<u>\$ 30,175,059</u>

Although third party payor balances in accounts receivable are used to calculate the allowance for uncollectible accounts, the uncollectible amounts for them are adjusted through contractual adjustments and not the provision for bad debt. Changes associated with third party allowances are included in the change in estimate amount. The Medical Centers allowance for doubtful accounts for self-pay patients decreased from 58 percent of self-pay accounts receivable at September 30, 2015 to 55 percent of self-pay accounts receivable at September 30, 2016.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 11. Patient Service Revenue (Continued)

Patient service revenue by major payor class, net of contractual allowances and before the provision for bad debts, consisted of the following for the year ended September 30, 2016:

	Amount	Percentage
Medicare	\$ 79,467,600	50%
Medicaid	55,665,094	35%
Blue Cross Blue Shield	22,329,344	14%
Other	1,941,693	1%
Patient service revenue, net of contractual allowances	<u>\$ 159,403,731</u>	<u>100%</u>

Note 12. Electronic Health Record Incentive Payments

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments for eligible hospitals and professionals that adopt and meaningfully use certified electronic health record (“EHR”) technology. The Medical Center must also attest to certain criteria in order to qualify to receive the incentive payments. The amount of the incentive payments are calculated for acute care hospitals using predetermined formulas based on discharges and patient days.

The Medical Center has included in patient revenues approximately \$395,000 related to incentive programs for Medicare for the year ended September 30, 2016. Incentive payments to be earned in the future could vary due to the Medical Center’s ability to continue to meet meaningful use requirements. As a part of operating this program, there is a possibility that government authorities may make adjustments to amounts previously recorded by the Medical Center, and its attestation of demonstrating meaningful use is also subject to review by the appropriate government authorities. The amount of revenue recognized is based on management’s best estimate, which is subject to change. Such changes will be reflected in the period in which the changes occur.

Note 13. Charity Care

The amount of charges foregone under the Medical Center's charity care policy for services and supplies furnished under the Medical Center's charity care policy aggregated \$8,919,923 for the year ended September 30, 2016.

The net cost of charity care provided was approximately \$2,450,611 for 2016. The net cost of charity care is determined by multiplying the ratio of cost to gross charges and applying this ratio to the gross uncompensated charges associated in providing care to charity patients.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 14. Operating Leases

The Medical Center leases various equipment and facilities under operating leases expiring at various dates through fiscal year 2021. Rental expense for the year ended September 30, 2016, for all operating leases totaled approximately \$2,370,000.

The following is a schedule of future minimum lease payments under non-cancellable operating leases as of September 30, 2016, that have initial or remaining lease terms in excess of one year:

Year Ending September 30,

2017	\$ 1,060,579
2018	511,262
2019	372,472
2020	315,360
2021	8,000
	<hr/>
Total	\$ 2,267,673

Note 15. Blended Component Unit

The St. Luke Foundation, Inc.

Condensed component unit information for The St. Luke Foundation, Inc., the Medical Center's blended component unit, for the year ended September 30, 2016, is as follows:

Condensed Statement of Net Position

Assets	
Current assets	\$ 13,576,039
Due from Medical Center	4,295,252
Capital assets, net	2,217,997
Other assets	614,359
	<hr/>
Total assets	20,703,647
Liabilities	
Current liabilities	5,493,739
Noncurrent liabilities	171,644
	<hr/>
Total liabilities	5,665,383
Net position	
Net investment in capital assets	1,876,443
Unrestricted	13,161,821
	<hr/>
Total net position	\$ 15,038,264

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 15. Blended Component Unit (Continued)**Condensed Statement of Revenues, Expenses, and Changes in Net Position**

Operating revenues	\$ 11,243,597
Operating expenses	
Operations	11,991,784
Depreciation	202,163
Total operating expenses	<u>12,193,947</u>
Operating loss	(950,350)
Nonoperating revenues	<u>119,459</u>
Special item - Gain on disposal of operations	<u>1,791,272</u>
Change in net position	960,381
Net position, beginning of year	<u>14,077,883</u>
Net position, end of year	<u><u>\$ 15,038,264</u></u>

Condensed Statement of Cash Flows

Net cash provided (used) by	
Operating activities	\$ (3,024,135)
Noncapital financing activities	1,472,762
Capital and related financing activities	(1,283,508)
Investing activities	<u>65,535</u>
Net decrease in cash and cash equivalents	(2,769,346)
Cash and cash equivalents, beginning of year	<u>5,754,436</u>
Cash and cash equivalents, end of year	<u><u>\$ 2,985,090</u></u>

Note 16. Commitments and Contingencies

The Medical Center is involved in litigation and regulatory investigations arising in the normal course of business. Based on consultations with legal counsel, management is of the opinion that these matters will be resolved without material adverse effect on the Medical Center's future financial position or on the results of its future operations.

SOUTHWEST MISSISSIPPI REGIONAL MEDICAL CENTER

Year Ended September 30, 2016

NOTES TO FINANCIAL STATEMENTS

Note 17. Subsequent Events

Management has evaluated subsequent events through February 22, 2017, the date which the financial statements were available to be issued.

Healthcare Agreement

On October 25, 2016, the Medical Center entered into a five (5) year agreement with Ochsner Health System (Ochsner) to assist with certain health care operations and health care management. The Medical Center had already entered into other ancillary agreements with Ochsner for professional employee lease services for oncology and cardiology which were made a part of this agreement. In addition, this agreement includes a supply chain agreement which should provide procurement based savings opportunities for the Medical Center.

Pharmacy Agreement

On October 27, 2016, the Medical Center entered into a five (5) year agreement with PROXSYS RX, LLC (PROXSYS) for the provision of retail pharmacy services at the Medical Center. The Medical Center is providing facility space to PROXSYS and PROXSYS is responsible for all necessary costs and expenses of operating the pharmacy, including, but not limited to costs and expenses associated with lease payments, drugs, pharmaceuticals, furniture, fixtures, equipment, inventory, supplies, personnel payroll and benefits, taxes, insurance and all other associated operating costs. In return for developing and providing ongoing management of a pharmacy integration program, the Medical Center has agreed to pay a one-time integration fee of \$200,000.

Self-Funded Health Insurance

Effective January 1, 2017, the Medical Center is providing health insurance coverage to its employees under a self-funded plan. Commercial insurance has been purchased for claims in excess of coverage provided by the Medical Center to limit the Medical Center's liability or losses under this program.