Memorial Medical Center
A Component Unit of Calhoun County, Texas

Auditor's Report and Financial Statements

December 31, 2012 and 2011

Memorial Medical Center
A Component Unit of Calhoun County, Texas
December 31, 2012 and 2011

Contents

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Independent Auditor's Report on Financial Statements and Supplementary Information

Board of Managers
Memorial Medical Center
Port Lavaca, Texas

We have audited the accompanying financial statements of Memorial Medical Center, a component unit of Calhoun County, which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Memorial Medical Center as of December 31, 2012 and 2011, and changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and pension information listed in the table of contents be presented to supplement the basic financial statements. Such information, although not 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 audits 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.

BKD, LLP

Houston, Texas
July 2, 2013

Memorial Medical Center
A Component Unit of Calhoun County, Texas
Management's Discussion and Analysis
Years Ended December 31, 2012 and 2011

Introduction

This management's discussion and analysis of the financial performance of Memorial Medical Center (the Medical Center) provides an overview of the Medical Center's financial activities for the years ended December 31, 2012 and 2011. It should be read in conjunction with the accompanying financial statements of the Medical Center. Unless otherwise indicated, amounts are rounded to the nearest thousand.

Financial Highlights

- Cash and investments increased in 2012 by $1,096,000, or 56 percent, and increased in 2011 by $425,000, or 28 percent.
- The Medical Center's net position increased in 2012 by $1,877,000, or 31 percent, and decreased in 2011 by $701,000, or 10 percent.
- The Medical Center reported operating income in 2012 of $149,000 and an operating loss in 2011 of $1,306,000. The operating income in 2012 increased by $1,455,000, or 111 percent, over the operating loss reported in 2011. The operating loss in 2011 decreased by $1,110,000, or 46 percent, from the operating loss reported in 2010.
- Net nonoperating revenues increased by $1,134,000 in 2012 compared to 2011, and decreased by $208,000 in 2011 compared to 2010.

Using This Annual Report

The Medical Center's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net position; and a statement of cash flows. These statements provide information about the activities of the Medical Center, including resources held by the Medical Center but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Medical Center is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Position

One of the most important questions asked about any Medical Center's finances is "Is the Medical Center as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues, expenses and changes in net position report information about the Medical Center's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Medical Center's net position and changes in it. The Medical Center's total net position—the difference between assets and liabilities—is one measure of the Medical Center's financial health or financial position. Over time, increases or decreases in the Medical Center's net position are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Medical Center's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Medical Center.

The Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments and net changes in cash resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash during the reporting period.

The Medical Center's Net Position

The Medical Center's net position is the difference between its assets and liabilities reported in the balance sheet. The Medical Center's net position increased by $1,877,000, or 31 percent, in 2012 and decreased by $701,000, or 10 percent, in 2011, as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2012	2011	2010
Assets			
Patient accounts receivable, net	$ 2,603,731	$ 2,335,134	$ 2,424,382
Other current assets	6,015,714	3,072,851	2,805,560
Capital assets, net	3,816,551	4,478,982	4,350,706
Total assets	$ 12,435,996	$ 9,886,967	$ 9,580,648
Liabilities and Net Position			
Liabilities			
Current liabilities	$ 4,028,468	$ 3,206,909	$ 1,951,485
Long-term Debt	505,724	655,329	903,832
Total liabilities	4,534,192	3,862,238	2,855,317
Net Position			
Net investment in capital assets	3,025,253	3,595,395	3,225,312
Restricted-expendable	31,620	36,813	1,000
Unrestricted	4,844,931	2,392,521	3,499,019
Total net position	7,901,804	6,024,729	6,725,331
Total liabilities and net position	$ 12,435,996	$ 9,886,967	$ 9,580,648

The most significant changes in the Medical Center's financial position during 2012 were a net increase in cash of $1,096,000 and an increase in other current assets of $1,609,000 for amounts receivables under the Medicaid Section 1115(a) demonstration program for Uncompensated Care and Delivery System

Reform Incentive Payments. Accrued liabilities increased by $696,000 for intergovernmental transfer payments (IGTs) to support the Medicaid Section 1115(a) demonstration program and $600,000 for IGTs to support the private uncompensated care program under the Medicaid Section 1115(a) demonstration program.

Operating Results and Changes in the Medical Center's Net Position

In 2012, the Medical Center's net position increased by $1,877,000, or 31 percent, as shown in Table 2. Total operating revenues increased primarily due to an increase of $1,517,000 in net amounts recognized under the Medicaid Section 1115(a) demonstration program in 2012 as compared to the public Upper Payment Limit (UPL) program in 2011. Excluding increases due to the Medicaid Section 1115(a) demonstration program total operating revenues increased 2.6 percent, while total operating expenses increased 2.7 percent. The Medical Center's participation in the private uncompensated care under the Medicaid Section 1115(a) demonstration program contributed to the increase in net position.

The Medical Center's change in net position shifted from a decrease of $1,639,000 in 2010 to a decrease of $701,000 in 2011, a decrease of 57 percent.

Table 2: Operating Results and Changes in Net Position

	2012	2011	2010
Operating Revenues			
Net patient service revenue	$ 20,202,316	$ 18,288,339	$ 18,344,803
Other operating revenues	555,508	462,481	452,302
Total operating revenues	20,757,824	18,750,820	18,797,105
Operating Expenses			
Salaries, wages and employee benefits	10,321,039	10,067,405	10,874,659
Purchased services and professional fees	4,788,952	4,471,955	4,548,770
Depreciation	1,015,970	919,782	891,839
Other operating expenses	4,482,498	4,597,893	4,897,701
Total operating expenses	20,608,459	20,057,035	21,212,969
Operating Income (Loss)	149,365	(1,306,215)	(2,415,864)
Nonoperating Revenues (Expenses)			
Noncapital grants	14,301	-	754,670
Interest income	3,514	6,784	11,329
Interest expense	(28,057)	(30,683)	(66,005)
Other	1,713,452	592,699	76,541
Total nonoperating revenues	1,703,210	568,800	776,535
Capital Contributions	24,500	36,813	0
Increase (Decrease) in Net Position	$ 1,877,075	$ (700,602)	$ (1,639,329)

Operating Income or Losses

The first component of the overall change in the Medical Center's net position is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. The Medical Center reported operating income in 2012 and for each of the prior two years an operating loss. The Medical Center was formed and is operated primarily to serve residents of Calhoun County and the surrounding area.

The operating income for 2012 increased by $1,455,000, or 111 percent, as compared to 2011. The primary components of the increase in operating income are increases in revenues. Net operating revenues for 2012 increased by $2,007,000, or 11 percent, which was primarily due to an increase of $1,517,000 in net amounts recognized under the Medicaid Section 1115(a) demonstration program in 2012 as compared to the public UPL program in 2011.

The operating loss for 2011 decreased by $1,110,000, or 46 percent, as compared to 2010. The primary components of the decreased operating loss are reductions in expenses, most notably salaries, wages and employee benefits expense. Operating expense decreased $1,156,000 or 5 percent, as compared to 2010, with the largest reduction in expenses, salaries and benefits expense, contributing a reduction of $807,000, or 7 percent, due to a reduction in workforce.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of grants and contributions to the Medical Center, investment income, interest expense and private UPL expense and on-behalf of payments. In the third full year of participation in the private UPL program, the Medical Center recognized private UPL expense of $790,000 and on-behalf of payments of $2,503,000 during 2012. The Medical Center recognized UPL expense of $1,050,000 and on-behalf of payments of $1,643,000 during 2011. Between 2012 and 2011, UPL expense decreased by $260,000 while on-behalf of payments increased by $860,000.

The Medical Center recognized a decrease in its grants and contributions during 2011 as compared to 2010, resulting primarily from a one-time donation of $715,000 during 2010, which did not occur during 2011.

The Medical Center's Cash Flows

During 2012, cash provided by operating activities decreased $534,000 over 2011, primarily due to a reduction of $575,000 in amounts due to third-party payers. Cash used in noncapital financing activities decreased $374,000 over 2011, due to decreased private UPL program payments. Cash used in capital and related financing decreased $834,000 due to decreased purchase of capital assets. Cash provided by investing activities remained consistent with 2011.

Capital Asset and Debt Administration

Capital Assets

At the end of 2012, the Medical Center had $3,817,000 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements.

Debt

At December 31, 2012, the Medical Center had $791,000 in capital lease obligations outstanding. During 2012, the Medical Center made regular capital lease payments and entered into a new capital lease in the amount of $157,700.

Contacting the Medical Center's Financial Management

This financial report is designed to provide our patients, suppliers and creditors with a general overview of the Medical Center's finances and to show the Medical Center's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Medical Center's management at Memorial Medical Center, 815 N. Virginia, Port Lavaca, Texas 77979.

Memorial Medical Center
A Component Unit of Calhoun County, Texas
Balance Sheets
December 31, 2012 and 2011

Assets

	2012	2011
Current Assets		
Cash	$ 2,541,589	$ 1,445,277
Short-term investments	500,000	500,000
Patient accounts receivable, net of allowance; 2012 - $4,208,000, 2011 - $3,985,000	2,603,731	2,335,134
Estimated amounts due from third-party payers	377,236	67,051
Supplies	628,145	564,040
Prepaid expenses and other	1,968,744	496,483
Total current assets	8,619,445	5,407,985
Capital Assets, Net	3,816,551	4,478,982
Total assets	$ 12,435,996	$ 9,886,967

See Notes to Financial Statements

Liabilities and Net Position

		2012		2011
Current Liabilities				
Current maturities of long-term debt	$	285,574	$	228,258
Notes payable		500,000		500,000
Accounts payable		812,633		936,536
Accrued expenses		2,430,261		967,384
Estimated amounts due to third-party payers		-		574,731
Total current liabilities		4,028,468		3,206,909
Long-term Debt		505,724		655,329
Total liabilities		4,534,192		3,862,238
Net Position				
Net investment in capital assets		3,025,253		3,595,395
Restricted-expendable for equipment		31,620		36,813
Unrestricted		4,844,931		2,392,521
Total net position		7,901,804		6,024,729
Total liabilities and net position	$	12,435,996	$	9,886,967

Memorial Medical Center
A Component Unit of Calhoun County, Texas
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2012 and 2011

	2012	2011
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2012 - $8,774,000, 2011 - $6,797,000	$ 20,202,316	$ 18,288,339
Other	555,508	462,481
Total operating revenues	20,757,824	18,750,820
Operating Expenses		
Salaries and wages	7,946,947	7,891,513
Employee benefits	2,374,092	2,175,892
Purchased services and professional fees	4,788,952	4,471,955
Insurance	57,889	45,621
Supplies and other	4,424,609	4,552,272
Depreciation and amortization	1,015,970	919,782
Total operating expenses	20,608,459	20,057,035
Operating Income (Loss)	149,365	(1,306,215)
Nonoperating Revenues (Expenses)		
Noncapital grants and contributions	14,301	-
Investment return	3,514	6,784
Interest expense	(28,057)	(30,683)
Private UPL expense	(790,000)	(1,050,000)
On-behalf of payments	2,503,452	1,642,699
Total nonoperating revenues	1,703,210	568,800
Excess (Deficiency) of Revenues Over Expenses Before Capital Grants and Gifts	1,852,575	(737,415)
Capital Contributions	24,500	36,813
Increase (Decrease) in Net Position	1,877,075	(700,602)
Net Position, Beginning of Year	6,024,729	6,725,331
Net Position, End of Year	$ 7,901,804	$ 6,024,729

Memorial Medical Center
A Component Unit of Calhoun County, Texas
Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	2012	2011
Operating Activities		
Receipts from and on-behalf of patients	$ 18,194,660	$ 18,853,976
Payments to suppliers and contractors	(6,878,536)	(7,294,858)
Payments to employees	(10,153,750)	(10,121,256)
Other receipts, net	555,508	813,763
Net cash provided by operating activities	1,717,882	2,251,625
Noncapital Financing Activities		
Noncapital grants and contributions	14,301	-
Private UPL program payments	(190,000)	(1,050,000)
Proceeds from issuance of note payable	-	500,000
Net cash used in noncapital financing activities	(175,699)	(550,000)
Capital and Related Financing Activities		
Capital grants and gifts	24,500	36,813
Principal paid on long-term debt	(249,989)	(241,807)
Interest paid on long-term debt	(28,057)	(30,683)
Purchase of capital assets	(195,839)	(1,048,058)
Net cash used in capital and related financing activities	(449,385)	(1,283,735)
Investing Activities		
Interest on investments	3,514	6,784
Purchase of investments	(500,000)	(500,000)
Proceeds from disposition of investments	500,000	500,000
Net cash provided by investing activities	3,514	6,784
Increase in Cash	1,096,312	424,674
Cash, Beginning of Year	1,445,277	1,020,603
Cash, End of Year	$ 2,541,589	$ 1,445,277

Memorial Medical Center
A Component Unit of Calhoun County, Texas
Statements of Cash Flows (Continued)
Years Ended December 31, 2012 and 2011

	2012	2011
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by Operating Activities		
Operating income (loss)	$ 149,365	$ (1,306,215)
Depreciation and amortization	1,015,970	919,782
Provision for uncollectible accounts	8,774,000	6,797,000
On-behalf of payments	2,503,452	1,642,699
Changes in operating assets and liabilities:		
Patients accounts receivable, net	(9,042,597)	(6,707,752)
Estimated amounts due from and to third-party payers	(884,916)	739,680
Accounts payable and accrued expenses	738,974	263,997
Other assets and liabilities	(1,536,366)	(97,566)
Net cash provided by operating activities	$ 1,717,882	$ 2,251,625
Supplemental Cash Flows Information		
Capital lease obligation incurred for capital assets	$ 157,700	$ -

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

Nature of Operations and Reporting Entity

Memorial Medical Center (the Medical Center) is an acute care critical access hospital (CAH) located in Port Lavaca, Texas. The Medical Center is a component unit of Calhoun County (the County) and the Board of County Commissioners appoints members to the Board of Trustees (the Board) of the Medical Center. The Medical Center primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Calhoun County area.

Basis of Accounting and Presentation

The financial statements of the Medical Center have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Medical Center first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

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.

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; medical malpractice; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than employee health claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Medical Center is self-insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured portion of employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and Investment Income

Investments in certificates of deposit are carried at amortized cost. Investment income consists of interest income.

Patient Accounts Receivable

The Medical Center reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Medical Center provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Medical Center:

Land improvements	25-40 years
Buildings and leasehold improvements	25-40 years
Equipment	5-20 years

Compensated Absences

The Medical Center policies permit most employees to accumulate vacation that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date, plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Net Position

Net position of the Medical Center is classified in three components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net position is made up of noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the Medical Center. Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets or restricted net position.

Net Patient Service Revenue

The Medical Center has agreements with third-party payers that provide for payments to the Medical Center at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and include estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Medical Center provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Electronic Health Records (EHR) Incentive Program

The EHR Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified EHR technology. CAHs are eligible to receive incentive payments in the cost reporting period beginning in the federal fiscal year in which meaningful use criteria have been met. The Medicare incentive payment is for qualifying costs of the purchase of certified EHR technology multiplied by the Medical Center's Medicare share fraction, which includes a 20 percent incentive. This payment is an acceleration of amounts that would have been received in future periods based on reimbursable costs incurred, including depreciation. If meaningful use criteria are not met in future periods, the Medical Center is subject to penalties that would reduce future payments for services. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. The final amount for any payment year under both programs is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Medical Center has recognized the incentive payment revenue received for qualified EHR technology expenditures during 2011, which was the period during which management was reasonably assured meaningful use was achieved and the earnings process was complete. Management believes the incentive payments reflect a change in how "allowable costs" are determined in paying CAHs for providing services to Medicare beneficiaries. The Medical Center recorded revenue of $351,000, which is included in net patient service revenue in the statement of revenues, expenses and changes in net position as of the year ended December 31, 2011.

Income Taxes

As an essential government function of the County, the Medical Center is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the Medical Center is subject to federal income tax on any unrelated business taxable income.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 presentation. The reclassifications had no effect on the changes in financial position.

Note 2: Net Patient Service Revenue

The Medical Center has agreements with third-party payers that provide for payments to the Medical Center at amounts different from its established rates. These payment arrangements include:

Medicare. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid based on a cost reimbursement methodology. The Medical Center is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare administrative contractor.

Medicaid. Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Medical Center is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicaid administrative contractor.

Approximately 57 percent and 62 percent of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

On December 12, 2011, the United States Department of Health & Human Services approved a new Medicaid Section 1115(a) demonstration entitled "Texas Health Transformation and Quality Improvement Program." This demonstration will expand existing Medicaid managed care programs and establish two funding pools that will assist providers with uncompensated care costs and promote health system transformation. The demonstration is effective from December 12, 2011 to September 30, 2016, and will likely have a material impact on the Medical Center's future Medicaid funding. The funding received through this demonstration could impact the funding the Medical Center has historically received under the Texas Medicaid Disproportionate Share (DSH) program and will replace the funding historically received through the Upper Payment Limit (UPL) program, both designed to assist those facilities serving the majority of the indigent patients by providing funds supporting increased access to health care within the community. Total funding received through the Texas Medicaid supplemental funding programs was approximately $1,858,000 and $340,000 for the years ended December 31, 2012 and 2011, respectively.

The Medical Center has elected to fund certain elements of the State of Texas' private UPL program. During the years ended December 31, 2012 and 2011, the Medical Center recognized funding of approximately $790,000 and $1,050,000, respectively.

The Medical Center has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations 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.

Note 3: Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Medical Center is included in the County's deposit policy for custodial credit risk which requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Texas; bonds of any city, county, school district or special road district of the State of Texas; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

At December 31, 2012 and 2011, the Medical Center's bank balances were insured or collateralized by assets held in other than the Medical Center's name.

Summary of Carrying Values

The carrying values of deposits are included in the balance sheets as follows:

	2012	2011
Carrying value:		
Deposits	$ 3,041,589	$ 1,945,277

Included in the following balance sheet captions:

	2012	2011
Cash	$ 2,541,589	$ 1,445,277
Short term investments	500,000	500,000
	$ 3,041,589	$ 1,945,277

Note 4: Patient Accounts Receivable

The Medical Center grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31 consisted of:

	2012	2011
Medicare	$ 1,328,519	$ 1,081,114
Medicaid	403,784	308,122
Other third-party payers	1,322,614	974,942
Patients	3,756,814	3,955,956
	6,811,731	6,320,134
Less allowance for uncollectible accounts	4,208,000	3,985,000
	$ 2,603,731	$ 2,335,134

Note 5: Capital Assets

Capital assets activity for the years ended December 31 was:

	2012				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Capital assets:					
Land	$ 32,143	$ -	$ -	$ -	$ 32,143
Buildings and improvements	9,209,598	-	46,709	66,349	9,229,238
Equipment	13,165,705	174,456	1,744,174	-	11,595,987
Leased assets	1,495,000	157,700	-	-	1,652,700
Construction in progress	44,966	21,383	-	(66,349)	-
Total capital assets	23,947,412	353,539	1,790,883	0	22,510,068
Less accumulated depreciation:					
Buildings and improvements	(7,509,016)	(215,625)	(46,709)	-	(7,677,932)
Equipment	(11,315,733)	(527,523)	(1,744,174)	-	(10,099,082)
Leased assets	(643,681)	(272,822)	-	-	(916,503)
Total accumulated depreciation	(19,468,430)	(1,015,970)	(1,790,883)	0	(18,693,517)
Capital assets, net	$ 4,478,982	$ (662,431)	$ 0	$ 0	$ 3,816,551

	2011				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Capital assets:					
Land	$ 32,143	$ -	$ -	$ -	$ 32,143
Buildings and improvements	9,209,598	-	-	-	9,209,598
Equipment	12,162,613	1,003,092	-	-	13,165,705
Leased assets	1,495,000	-	-	-	1,495,000
Construction in progress	-	44,966	-	-	44,966
Total capital assets	22,899,354	1,048,058	0	0	23,947,412
Less accumulated depreciation:					
Buildings and improvements	(7,293,703)	(215,313)	-	-	(7,509,016)
Equipment	(10,860,431)	(455,302)	-	-	(11,315,733)
Leased assets	(394,514)	(249,167)	-	-	(643,681)
Total accumulated depreciation	(18,548,648)	(919,782)	0	0	(19,468,430)
Capital assets, net	$ 4,350,706	$ 128,276	$ 0	$ 0	$ 4,478,982

Note 6: Notes Payable

The following is a summary of notes payable transactions for the Medical Center for the years ended December 31:

	Beginning Balance	Additions	Deductions	Ending Balance
Notes payable:				
Noninterest-bearing note - 2012	$ 500,000	$ 0	$ 0	$ 500,000
Noninterest-bearing note - 2011	$ 0	$ 500,000	$ 0	$ 500,000

The Medical Center was approved for a $2,000,000 line of credit with Calhoun County in 2011 and an additional $2,000,000 line of credit in 2012. As of December 31, 2012, only $500,000 had been drawn on the original line of credit, and no amounts had been drawn on the second line of credit.

Note 7: Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses included in current liabilities at December 31 consisted of:

	2012	2011
Payable to suppliers and contractors	$ 609,011	$ 775,621
Payable to employees (including payroll taxes and benefits)	1,134,673	967,384
Other	1,499,210	160,915
	$ 3,242,894	$ 1,903,920

Note 8: Medical Malpractice Claims

The Medical Center is a unit of government covered by the Texas Tort Claims Act, which, by statute, limits its liability to $100,000 per individual and $300,000 in the aggregate. These limits coincide with the malpractice insurance coverage, which is purchased by the Medical Center under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Medical Center's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 9: Employee Health Claims

Substantially all of the Medical Center's employees and their dependents are eligible to participate in the Medical Center's employee health insurance plan. The Medical Center is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of $60,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Medical Center's estimate could change by a material amount in the near term.

Activity in the Medical Center's accrued employee health claims liability during 2012 and 2011 is summarized as follows:

	2012	2011
Balance, beginning of year	$ 145,000	$ 285,000
Current year claims incurred and changes in estimates for claims incurred in prior years	977,566	818,061
Claims and expenses paid	(854,697)	(958,061)
Balance, end of year	$ 267,869	$ 145,000

Note 10: Long-term Obligations

The following is a summary of long-term obligation transactions for the Medical Center for the years ended December 31:

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt:					
Capital lease obligations - 2012	$ 883,587	$ 157,700	$ (249,989)	$ 791,298	$ 285,574
Capital lease obligations - 2011	$ 1,125,394	$ 0	$ (241,807)	$ 883,587	$ 228,258

Capital Lease Obligations

The Medical Center is obligated under leases for equipment that are accounted for as capital leases. Assets under capital leases at December 31, 2012 and 2011, totaled $736,197 and $851,319, respectively, net of accumulated depreciation of $916,503 and $643,681, respectively. The following is a schedule, by year, of future minimum lease payments under capital leases, including interest, at rate of 2.98 percent to 5.00 percent, together with the present value of the future minimum lease payments as of December 31, 2012:

Years Ending December 31,	Total to be Paid	Principal	Interest
2013	$ 307,753	$ 285,575	$ 22,178
2014	307,753	294,819	12,934
2015	171,622	167,395	4,227
2016	35,490	34,099	1,391
2017	9,489	9,410	79
	$ 832,107	$ 791,298	$ 40,809

Note 11: Charity Care

The costs of charity care provided under the Medical Center's charity care policy were approximately $447,000 and $660,000 for 2012 and 2011, respectively. The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross uncompensated charges.

Note 12: Pension Plan

Plan Description

The Medical Center provides retirement, disability and death benefits for all of its full-time employees through a nontraditional defined benefit pension plan (the plan) in the state-wide Texas County and District Retirement System (TCDRS). The Board of Trustees of TCDRS is responsible for the administration of the state-wide agent multiple-employer public employee retirement system consisting of over 600 nontraditional defined benefit pension plans. TCDRS, in the aggregate, issues a comprehensive annual financial report (CAFR) on a calendar year basis. The CAFR is available upon written request from the TCDRS Board of Trustees at P.O. Box 2034, Austin, Texas 78768-2034.

The plan provisions are adopted by the governing body of the employer, within the options available in the Texas state statutes governing TCDRS (TCDRS Act). Members can retire at ages 60 and above with eight or more years of service, with 30 years of service regardless of age, or when the sum of their age and years of service equals 75 or more. Members are vested after eight years of service but must leave their accumulated contributions in the plan to receive any employer-financed benefit. Members who withdraw their personal contributions in a lump sum are not entitled to any amounts contributed by their employer.

Benefit amounts are determined by the sum of the employee's contributions to the plan, with interest, and employer-financed monetary credits. The level of these monetary credits is adopted by the governing body of the Medical Center within the actuarial constraints imposed by the TCDRS Act so that the resulting benefits can be expected to be adequately financed by the Medical Center's commitment to contribute. At retirement, death or disability, the benefit is calculated by converting the sum of the employee's accumulated contributions and the employer-financed monetary credits to a monthly annuity using annuity purchase rates prescribed by the TCDRS Act.

Funding Policy

The Medical Center has elected the annually determined contribution rate plan provisions of the TCDRS Act. The plan is funded by monthly contributions from both employee members and the employer based on the covered payroll of employee members. Under the TCDRS Act, the contribution rate of the Medical Center is actuarially determined annually. It was 7.46 percent and 7.19 percent for calendar years 2012 and 2011, respectively. The contribution rate payable by the employee members is 7.00 percent as adopted by the governing body of the Medical Center. The employee contribution rate and the employer contribution rate may be changed by the governing body of the Medical Center within the options available in the TCDRS Act.

Annual Pension Cost

For the Medical Center's fiscal year ended December 31, 2012, the annual pension cost (APC) for the TCDRS plan for its employees was $590,398, and the actual contributions were $590,398. For the Medical Center's fiscal year ended December 31, 2011, the annual pension cost for the TCDRS plan for its employees was $565,712, and the actual contributions were $565,712. There is no existing net pension obligation.

The required contributions for 2012 and 2011 were determined based on the results of actuarial valuations as of December 31, 2011 and 2010, using the entry age normal actuarial cost method. The actuarial assumptions included (a) an 8.0 percent investment rate of return (net of administrative expenses) and (b) projected salary increase of 5.4 percent for both 2011 and 2010. Both (a) and (b) included an inflation component of 3.5 percent value method. The actuarial valuation of plan assets was determined using a ten-year smoothed value and a fund value. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period at both December 31, 2011 and 2010, was 20 years.

Three-year Trend Information

Fiscal Year Ended	APC	Percentage of APC Contributed	Net Pension Obligation
12/31/2010	$ 603,847	100%	$ -
12/31/2011	565,712	100%	-
12/31/2012	590,398	100%	-

Funding Status and Funding Progress

As of December 31, 2011, the most recent actuarial valuation date, the plan was 92.51 percent funded. The actuarial accrued liability for benefits was $20,308,106 and the actuarial value of assets was $18,787,462, resulting in an unfunded actuarial accrued liability (UAAL) of $1,520,644. The covered payroll (annual payroll of active employees covered by the plan) was $7,868,071 and the ratio of the UAAL to the covered payroll was 19.33 percent.

The schedule of funding progress, presented as required supplementary information following the notes to financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Note 13: Related-party Transactions

The Medical Center collaborates with the Service Organization of Houston (the Service Organization), a nonprofit corporation, to access Medicaid supplemental payments through the State of Texas' private UPL program. The Medical Center has one representative who serves on the Board of Directors of the Service Organization. The Service Organization funded certain health care services on behalf of the Medical Center in the amounts of approximately $2,503,000 and $1,643,000 during the years ended December 31, 2012 and 2011, respectively. These on-behalf of payments are reflected as nonoperating revenues in the accompanying statements of revenues, expenses and changes in net position.

Note 14: Contingencies

Litigation

In the normal course of business, the Medical Center is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Medical Center's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Medical Center evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Note 15: Patient Protection and Affordable Care Act

The Patient Protection and Affordable Care Act (PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which will provide individuals without employer-provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional.

The State of Texas has currently indicated it will not expand the Medicaid program, which may result in revenues from newly covered individuals not offsetting the Medical Center's reduced revenue from other Medicare/Medicaid programs.

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible it will have a negative impact on the Medical Center's net patient service revenue. In addition, it is possible the Medical Center will experience payment delays and other operational challenges during PPACA's implementation.

Required Supplementary Information

Memorial Medical Center
A Component Unit of Calhoun County, Texas
Schedule of Funding Progress for TCDRS Retirement Plan
Year Ended December 31, 2012

Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Ratio of Assets to AAL (a/b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Annual Covered Payroll (c)	OAAL as Percentage of Covered Payroll ((b-a)/c)
12/31/09	$ 17,433,357	$ 18,700,370	93.22%	$ 1,267,013	$ 9,433,820	13.43%
12/31/10	18,348,643	19,726,385	93.02	1,377,742	8,340,424	16.52
12/31/11	18,787,462	20,308,106	92.51	1,520,644	7,868,071	19.33