Michigan Department of Treasury
496 (02/06)

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type	Local Unit Name	County
☐County ☐City ☐Twp ☐Village ☒Other	Three Rivers Health	St. Joseph

Fiscal Year End	Opinion Date	Date Audit Report Submitted to State
December 31, 2007	March 18, 2008	March 24, 2008

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

	YES	NO	**Check each applicable box below**. (See instructions for further detail.)
1.	☒	☐	All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2.	☒	☐	There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3.	☒	☐	The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4.	☒	☐	The local unit has adopted a budget for all required funds.
5.	☒	☐	A public hearing on the budget was held in accordance with State statute.
6.	☒	☐	The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7.	☒	☐	The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8.	☒	☐	The local unit only holds deposits/investments that comply with statutory requirements.
9.	☒	☐	The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan,* as revised (see Appendix H of Bulletin).
10.	☒	☐	There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11.	☒	☐	The local unit is free of repeated comments from previous years.
12.	☒	☐	The audit opinion is UNQUALIFIED.
13.	☒	☐	The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14.	☒	☐	The board or council approves all invoices prior to payment as required by charter or statute.
15.	☒	☐	To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)
Financial Statements	☒	
The letter of Comments and Recommendations	☒	
Other (Describe)	☐	

Certified Public Accountant (Firm Name)	Telephone Number		
Plante & Moran, PLLC	269-567-4500		
Street Address	**City**	**State**	**Zip**
750 Trade Centre Way, Suite 300	Portage	MI	49002

Authorizing CPA Signature	Printed Name	License Number
Oliver Jurkovic	Oliver Jurkovic	1101021651

Three Rivers Health

Consolidated Financial Report
December 31, 2007

Three Rivers Health

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Independent Auditor's Report

To the Board of Directors
Three Rivers Health

We have audited the accompanying consolidated balance sheet of Three Rivers Health (the "Hospital") as of December 31, 2007 and 2006 and the related consolidated statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Three Rivers Health at December 31, 2007 and 2006 and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements do not present a management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be a part of, the basic financial statements.

Plante & Moran, PLLC

March 18, 2008

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

Three Rivers Health

Consolidated Balance Sheet

	December 31, 2007	December 31, 2006
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	$ 1,507,763	$ 799,233
Accounts receivable (Note 3)	5,145,032	4,535,540
Estimated third-party payor settlements (Note 5)	154,151	1,612,000
Assets limited as to use (Note 2)	290,892	285,834
Other current assets	1,119,658	1,108,372
Total current assets	8,217,496	8,340,979
Assets Limited as to Use - Net of current portion (Note 2)	2,621,253	2,450,818
Property and Equipment - Net (Note 4)	16,083,247	17,129,029
Total assets	**$ 26,921,996**	**$ 27,920,826**
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 6)	$ 1,468,199	$ 1,425,261
Accounts payable	2,967,308	2,502,074
Accrued liabilities and other:		
Accrued compensation	515,083	565,685
Accrued compensated absences	1,077,540	1,016,549
Other accrued liabilities	625,856	514,374
Total current liabilities	6,653,986	6,023,943
Long-term Debt - Net of current portion (Note 6)	7,769,862	8,962,827
Total liabilities	14,423,848	14,986,770
Net Assets		
Invested in capital assets - Net of related debt	6,845,186	6,740,941
Restricted for debt service	290,892	285,834
Unrestricted	5,362,070	5,907,281
Total net assets	12,498,148	12,934,056
Total liabilities and net assets	**$ 26,921,996**	**$ 27,920,826**

See Notes to Consolidated Financial Statements.

Three Rivers Health

Consolidated Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended	
	December 31, 2007	December 31, 2006
Operating Revenues		
Net patient service revenue	$ 45,020,919	$ 43,452,198
Other	1,873,405	903,204
Total operating revenues	46,894,324	44,355,402
Operating Expenses		
Salaries and wages	17,593,768	16,774,855
Employee benefits and payroll taxes	6,277,969	5,495,569
Operating supplies and expenses	5,423,111	4,791,385
Other	15,569,107	13,921,183
Depreciation and amortization	2,122,042	2,037,079
Total operating expenses	46,985,997	43,020,071
Operating (Loss) Income	(91,673)	1,335,331
Nonoperating Revenue (Expense)		
Interest income	199,350	120,211
Contributions	25,036	56,466
Interest expense	(568,621)	(522,716)
Total nonoperating expense	(344,235)	(346,039)
(Decrease) Increase in Net Assets	(435,908)	989,292
Net Assets - Beginning of year	12,934,056	11,944,764
Net Assets - End of year	**$ 12,498,148**	**$ 12,934,056**

See Notes to Consolidated Financial Statements.

Three Rivers Health

Consolidated Statement of Cash Flows

	Year Ended December 31, 2007	Year Ended December 31, 2006
Cash Flows from Operating and Nonoperating Activities		
Cash received from patients and third-party payors	$ 45,869,276	$ 41,536,116
Cash payments to employees and suppliers	(44,288,136)	(40,838,144)
Other receipts from operations	1,873,405	903,204
Net cash provided by operating activities	3,454,545	1,601,176
Cash Flows from Noncapital Financing Activities -		
Donations	25,036	56,466
Cash Flows from Investing Activities		
Investment income	199,350	120,211
Cash invested in assets limited as to use	22,154	(195,145)
Net cash provided by (used in) investing activities	221,504	(74,934)
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(770,257)	(1,350,680)
Interest paid on long-term debt	(568,621)	(522,716)
Principal payments on long-term debt	(1,456,030)	(1,338,543)
Net cash used in capital and related financing activities	(2,794,908)	(3,211,939)
Net Increase (Decrease) in Cash and Cash Equivalents	906,177	(1,629,231)
Cash and Cash Equivalents - Beginning of year	1,178,050	2,807,281
Cash and Cash Equivalents - End of year	**$ 2,084,227**	**$ 1,178,050**
Balance Sheet Classification for Cash		
Current assets	$ 1,507,763	$ 799,233
Assets limited as to use	576,464	378,817
Total cash	**$ 2,084,227**	**$ 1,178,050**

See Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows (Continued)

A reconciliation of operating (loss) income to net cash from operating activities is as follows:

	Year Ended	
	December 31, 2007	December 31, 2006
Cash Flows from Operating Activities		
Operating (loss) income	$ (91,673)	$ 1,335,331
Adjustments to reconcile operating (loss) income to net cash from operating activities:		
Depreciation	2,122,042	2,037,079
Provision for bad debts	5,252,428	4,093,914
Changes in assets and liabilities:		
Increase in patient accounts receivable	(5,861,920)	(3,865,996)
Decrease (increase) decrease in third-party settlement receivables	1,457,849	(1,612,000)
Increase in other current assets	(11,286)	(158,527)
Increase in accounts payable	465,234	84,964
Increase in other accrued expenses	121,871	218,411
Decrease in third-party settlement payables	-	(532,000)
Net cash provided by operating activities	**$ 3,454,545**	**$ 1,601,176**

Significant noncash investing, capital, and financing activities for 2007 and 2006 are as follows:

In 2007 and 2006, the Hospital entered into capital lease agreements in the amount of $306,003 and $336,713, respectively.

Note 1 - Nature of Business and Significant Accounting Policies

Three Rivers Health (the "Hospital") is a governmental unit that operates a short-term acute-care facility providing inpatient, rehabilitation, and outpatient healthcare services to the Three Rivers, Michigan area. The accompanying consolidated financial statements include accounts of both the Hospital and several blended component units. All intercompany balances have been appropriately eliminated from the consolidated financial statements. These financial statements consolidate the activities of the Hospital and the following component units:

- TRAH Properties - Leases space to the Hospital for services provided to its patients
- Integrated Health Systems (IHS) - Employs physicians who work at the Hospital as contracted employees
- Physicians Health Organization (PHO) - Joint venture between the Hospital and local physicians to provide computer services, as well as a 50-50 risk share pool to doctors who refer patients to the Hospital
- Three Rivers Health Foundation - Obtains funds to directly benefit the Hospital

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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Presentation - The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34 that provide a comprehensive look at the Hospital's financial activities.

Enterprise Fund Accounting - The Hospital uses Enterprise Fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Affiliated Organization - The Hospital has a formal agreement with a local healthcare provider whereby both organizations will work toward the mutual benefit of one another in furtherance of promoting an integrated healthcare delivery system in southwestern Michigan. The Hospital has available the technical and financial resources of its affiliate and participates in the affiliate's sponsored managed care programs. This affiliation agreement terminates October 31, 2008.

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use.

Assets Limited as to Use - Assets limited as to use include assets set aside by the board of trustees for future capital improvements over which the board retains control and may at its discretion subsequently use for other purposes and assets temporarily restricted under terms of a bond agreement for future bond payments and capital projects.

Investments - Investments are carried at fair value.

Property and Equipment - Property and equipment are stated at cost. Maintenance and repairs are charged to expense as incurred. Depreciation has been charged to operations using the straight-line method and includes amortization of equipment under capital leases.

Paid Time Off - The Hospital maintains a paid time off benefit policy. The benefits are charged to operations when earned. Unused benefits are recorded as a current liability in the consolidated financial statements.

Classification of Net Assets - Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. Unrestricted net assets are remaining net assets that do not meet the definition of the other two categories of net assets. Included in the unrestricted net assets reported at December 31, 2007 and 2006 is $2,621,253 and $2,450,818, respectively, which has been designated by the Hospital's board of trustees for future capital acquisitions. Designated funds remain under the control of the board of trustees, which may at its discretion later use the funds for other purposes.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

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

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

Operating Revenue and Expenses - The Hospital's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing healthcare services - the Hospital's principal activity. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs. Nonoperating activities, including investment income and contributions received for purposes other than capital asset acquisition, and interest expense, are reported as nonoperating revenue and expense.

Tax Status - The Hospital, TRAH Properties, and Three Rivers Health Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. IHS is deemed a corporation and files an 1120, with no tax due, and PHO files a 1065 partnership return.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Note 2 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. A local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Hospital has adopted an investment policy that follows Public Act 20 of 1943, as amended.

The Hospital's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. At December 31, 2007 and 2006, the Hospital had deposits of $2,096,052 and $2,001,210, respectively, of bank deposits (checking, savings, and money market accounts), of which $500,000 and $381,695, respectively, was covered by FDIC insurance. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Concentration of Credit Risk - The Hospital places no limit on the amount the Hospital may invest in any one type of investment.

Assets Limited as to Use - The detail of assets limited as to use, consisting of cash and investments in government-backed securities, is summarized in the following schedule:

	2007	2006
Restricted under the terms of the bond agreement for debt service	$ 290,892	$ 285,834
Designated by board for future capital acquisitions	2,621,253	2,450,818
Total assets limited as to use	2,912,145	2,736,652
Less current portion	290,892	285,834
Total long-term assets limited as to use	$ 2,621,253	$ 2,450,818

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2007	2006
Patient accounts receivable	$ 15,638,032	$ 12,827,540
Less:		
Allowance for uncollectible accounts	(2,854,000)	(1,924,000)
Allowance for contractual adjustments	(7,639,000)	(6,368,000)
Net patient accounts receivable	$ 5,145,032	$ 4,535,540

	Percentage	
	2007	2006
Medicare and Medicare HMO plans	26	28
Blue Cross/Blue Shield of Michigan	16	16
Medicaid and Medicaid HMO plans	21	17
Other insurance	16	23
Self-pay	21	16
Total	100	100

Note 4 - Capital Assets

Cost of capital assets and related depreciable lives for December 31, 2007 are summarized below:

	2006	Additions	Transfers	Retirements	2007	Depreciable Life - Years
Land	$ 219,500	$ -	$ -	$ -	$ 219,500	-
Land and land improvements	1,034,245	3,095	-	-	1,037,340	5-25
Buildings and improvements	19,183,737	143,912	-	-	19,327,649	10-40
Furniture, fixtures, and equipment	18,960,615	623,250	189,732	-	19,773,597	3-20
Buildings and equipment under capital lease	3,993,334	306,003	(189,732)	-	4,109,605	3-40
Total	43,391,431	1,076,260	-	-	44,467,691	
Less accumulate depreciation:						
Land and land improvements	801,017	73,248	-	-	874,265	
Buildings and improvements	7,715,361	1,095,544	-	-	8,810,905	
Furniture, fixtures, and equipment	16,710,976	715,440	-	-	17,426,416	
Buildings and equipment under capital lease	1,035,048	237,810	-	-	1,272,858	
Total	26,262,402	2,122,042	-	-	28,384,444	
Net carrying amount	$ 17,129,029	$ (1,045,782)	$ -	$ -	$ 16,083,247	

Note 4 - Capital Assets (Continued)

Cost of capital assets and related depreciable lives for December 31, 2006 are summarized below:

	2005	Additions	Transfers	Retirements	2006	Depreciable Life - Years
Land	$ 219,500	$ -	$ -	$ -	$ 219,500	-
Land and land improvements	1,015,262	18,983	-	-	1,034,245	5-25
Buildings and improvements	13,629,263	143,695	5,410,779	-	19,183,737	10-40
Furniture, fixtures, and equipment	18,526,562	434,053	-	-	18,960,615	3-20
Buildings and equipment under capital lease	3,656,621	336,713	-	-	3,993,334	3-40
Construction in progress	4,656,830	753,949	(5,410,779)	-	-	
Total	41,704,038	1,687,393	-	-	43,391,431	
Less accumulated depreciation:						
Land and land improvements	745,208	55,809	-	-	801,017	
Buildings and improvements	6,839,611	875,750	-	-	7,715,361	
Furniture, fixtures, and equipment	15,883,891	827,085	-	-	16,710,976	
Buildings and equipment under capital lease	756,613	278,435	-	-	1,035,048	
Total	24,225,323	2,037,079	-	-	26,262,402	
Net carrying amount	$ 17,478,715	$ (349,686)	$ -	$ -	$ 17,129,029	

Note 5 - Cost Report Settlements

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Approximately 70 percent of the Hospital's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs. Subsidiaries of the Hospital have agreements with third-party payors that provide for reimbursement at amounts different from established rates. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient, acute-care, swing-bed, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Inpatient rehabilitation services are reimbursed at cost subject to a per case limit. Outpatient services related to Medicare beneficiaries are paid at fee-for-service rates.

- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Outpatient services are paid at fee-for-service rates.

- **Blue Cross/Blue Shield of Michigan** - The Hospital is paid controlled charges for services provided to Blue Cross/Blue Shield subscribers.

Note 5 - Cost Report Settlements (Continued)

Laws and regulations governing the Medicare, Medicaid, and Blue Cross/Blue Shield programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements. Cost report settlements increased net patient service revenue by approximately $860,000 in 2007.

Note 6 - Long-term Debt

Long-term liability activity for the year ended December 31, 2007 was as follows:

	2006	Current Year Additions	Current Year Reductions	2007	Amounts Due Within One Year
Series 1993	$ 2,050,000	$ -	$ (655,000)	$ 1,395,000	$ 680,000
Series 1997	1,811,000	-	(280,000)	1,531,000	300,000
Series 2004	3,779,137	-	(158,796)	3,620,341	163,534
Lease payable to affiliate	2,183,694	-	(119,148)	2,064,546	126,790
Leases payable	564,257	306,003	(243,086)	627,174	197,875
Total long-term debt	$ 10,388,088	$ 306,003	$ (1,456,030)	$ 9,238,061	$ 1,468,199

Long-term liability activity for the year ended December 31, 2006 was as follows:

	2005	Current Year Additions	Current Year Reductions	2006	Amounts Due Within One Year
Series 1993	$ 2,675,000	$ -	$ (625,000)	$ 2,050,000	$ 655,000
Series 1997	2,071,000	-	(260,000)	1,811,000	280,000
Series 2004	3,933,034	-	(153,897)	3,779,137	158,797
Lease payable to affiliate	2,296,504	-	(112,810)	2,183,694	119,649
Leases payable	414,380	336,713	(186,836)	564,257	211,815
Total long-term debt	$ 11,389,918	$ 336,713	$ (1,338,543)	$ 10,388,088	$ 1,425,261

The bonds payable are summarized as follows:

- Bonds payable - 1993 Series, total annual principal payments ranging from $680,000 due in 2008 to $715,000 due in 2009, collateralized by net revenue derived from the operations of the Hospital. The interest rate is 5.44 percent.

Note 6 - Long-term Debt (Continued)

- Bonds payable - 1997 Series, total annual principal payments ranging from $300,000 due in 2008 to $370,000 due in 2011, with the last payment of $181,000 scheduled to be made in May 2012, collateralized by net revenue derived from the operations of the Hospital. The interest rate is 5.59 percent.
- Bonds payable - 2004 Series, total annual principal payments ranging from $163,534 due in 2008 to $270,485 due in 2024. The debt is collateralized by the net revenue derived from the operations of the Hospital. The interest rate is 4.94 percent.
- Lease payable to an affiliate organization, monthly installments aggregating approximately $20,500, including interest at 6.0 percent per annum, collateralized by two buildings
- Leases payable, monthly installments aggregating approximately $20,000, including interest at 5.08 percent - 5.73 percent per annum, collateralized by equipment

The following is a schedule by years of bond principal and interest as of December 31, 2007:

Year Ending December 31	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2008	$ 1,143,534	$ 259,734	$ 324,665	$ 147,979
2009	1,214,059	199,756	294,315	130,082
2010	524,442	146,271	278,247	114,164
2011	549,996	120,872	255,664	98,197
2012	366,469	94,437	189,676	85,260
2013-2017	1,020,952	363,624	960,076	265,718
2018-2022	1,194,242	190,333	389,077	20,374
2023-2024	532,647	21,185	-	-
Total payments	$ 6,546,341	$ 1,396,212	$ 2,691,720	$ 861,774

Note 7 - Future Revenues Pledged for Debt Payment

The Hospital has pledged substantially all net revenue derived from operations to repay the revenue bonds listed in Note 6. The remaining principal and interest to be paid on the bonds total approximately $7,600,000. During the current year, net operating revenues of the system were approximately $46,900,000 compared to the annual debt requirements of approximately $1,400,000.

Note 8 - Defined Contribution Pension Plan

The Hospital maintains a defined contribution retirement plan covering substantially all employees. The Hospital has recognized contribution expense totaling $594,529 and $614,454 during the years ended December 31, 2007 and 2006, respectively. Expense was determined in accordance with the plan formula as follows:

The Hospital will make fixed contributions of employees' W-2 wages for those employees who have completed their probationary period and are employed on either a full-time or part-time basis during the final pay period of each calendar year. The fixed contributions will be paid during the first quarter of each succeeding year. The fixed contribution rates are set forth as follows:

- Employees who have completed their probationary period up to 10 years of services - 2 percent employer contribution
- Employees who have completed 11 to 14 years of service - 3 percent employer contribution
- Employees who have completed 15 years of service and up - 4 percent employer contribution

In addition, the Hospital will make matching contributions equal to 50 percent of an employee's contributions, up to a maximum of 2 percent of the employee's compensation.

Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for property loss, fraud, director and officer liability, professional liability, malpractice, general liability, employee medical, and workers' compensation claims.

The Hospital is insured against medical malpractice claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claim or aggregate claims exceeding claim limits asserted in the policy year. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

Note 9 - Risk Management (Continued)

There are several pending malpractice claims against the Hospital. There is insurance coverage, but it is possible that the liability for the claims may exceed the aggregate insurance coverage. Presently, it is not possible to determine the resolution of the claims or amount of liability, if any. Accruals for estimated deductibles are included in current liabilities at December 31, 2007 and 2006.

Note 10 - Charity Care

The Hospital maintains records to identify and monitor the level of charity care provided. These records include the amount of charges forgone for services and supplies rendered under its charity care policy. The following information measures the level of charity care provided:

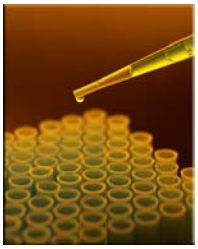
	2007	2006
Charges forgone, based on established rates	$ 380,032	$ 330,313

In addition, under arrangements with various governmental insurance programs, the Hospital and subsidiaries provide significant care to the local indigent population for which reimbursement for services rendered is generally less than the cost of providing such services. As part of their obligation to the local communities, the Hospital and subsidiaries also provide numerous other services that benefit the communities and are generally performed at no charge.

Three Rivers Health

Report to the Board of Directors and Finance Committee

December 31, 2007



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Significant Deficiency and Management Letter Comments

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To the Board of Directors
and Finance Committee
Three Rivers Health

We have audited the consolidated financial statements of Three Rivers Health as of and for the year ended December 31, 2007 and have issued our report thereon dated March 18, 2008, in accordance with auditing standards generally accepted in the United States of America. We considered the Hospital's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's consolidated financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

We have also summarized some additional areas for management's consideration.

Praxity MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS

All items are presented for your consideration as outlined below:

Title	Exhibit
Management Discussion and Analysis - Significant Deficiency	A
Allowance for Bad Debts	B
Information Technology Controls	C
Investments	D
Accrued Payroll	E
Accounts Payable	F
Capital Leases and Disposals	G
IRS Form 990 Changes	H
403(b) Pension Plans - New Audit Requirement	I

This communication is intended solely for the information and use of management, the board of directors, the finance committee, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties.

Thank you for the opportunity to be of service to the Hospital. Should you wish to discuss any of the items included in this report, we would be happy to do so.

Plante & Moran, PLLC

March 18, 2008

Exhibit A
Management's Discussion and Analysis

The Hospital is considered a governmental entity and, therefore, is required to present a management's discussion and analysis as supplemental information. The Hospital has chosen not to present this information. Although it is typical of many governmental healthcare entities to not compile a management's discussion and analysis report, it is considered a significant deficiency under SAS 112.

Exhibit B
Allowance for Bad Debts

During our audit procedures related to accounts receivable and the related allowance for bad debts, we noted management is not performing a hindsight analysis to evaluate the adequacy of the allowance for bad debts.

We recommend that management complete this analysis on a semiannual basis. The analysis will help management evaluate the adequacy of the allowance, as well as show trends in write-offs. The analysis will also help management identify the need for any potential changes to the current allowance for bad debt model. This will help to ensure the allowance for bad debts remains adequate when changes in payor mix or write-offs occur.

Exhibit C
Information Technology Controls

Access Termination

Observation: Hospital information technology staff indicates that they do not have transaction level logging enabled. Last log in date and time are not confirmed.

Recommendation: For key accounting and operational staff, transaction level logging should be enabled prior to and immediately after the termination date. The transactions of the user should be reviewed by a supervisor or human resources to ensure that unauthorized activity is detected and reviewed at termination.

Access Changes

Observation: Currently, no formal process is in place for annual access review to ensure access is commensurate with user's job responsibility.

Recommendation: Management should implement a process to review user access at least annually. This is best achieved when the review is performed by someone other than information technology (as they administer access). Access reports should be provided by information technology to each supervisor or to human resources for review of access. Any exceptions should be clearly documented with IT remediation and retained for the duration of the audit.

Authentication Controls - Network

Network observation: Password length is set to five characters. Password complexity is not enforced.

Application observation: Password length is set to six characters. Password expiration is set to 180 days.

Recommendation: To avoid passwords from being easily guessed, current password settings should be strengthened as follows:

a. Password length should be increased to seven or more characters

b. Password expiration should be decreased to 90 days or less

c. Password complexity should be enforced.

Exhibit D
Investments

The Hospital's investment policy has not been updated since 2000. Also, Michigan Public Act 213 was passed and is effective as of December 27, 2007. This act requires investment managers of the Hospital to comply with the following:

1. Acknowledge receipt of the Hospital's investment policy
2. Agree to comply with the Hospital's investment policy
3. Provide quarterly a written report to the governing body concerning the investment of funds

We recommend updating the investment policy for Public Act 213, as well as any other appropriate changes that should be made.

Exhibit E
Accrued Payroll

During our audit procedures related to accrued payroll, it was noted the accrual for payroll and related taxes at year end was overstated by approximately $100,000. The overstatement was related to the employer portion of FICA, which was accrued twice.

We recommend management review the procedures in place regarding the accrued payroll process to help ensure accrued payroll is properly stated at month end and year end.

Exhibit F
Accounts Payable

During the audit, finance staff brought to our attention an unrecorded invoice. This invoice should have been included in accounts payable and expenses in 2007.

We recommend that management review procedures in place regarding the accrual of unpaid invoices to help ensure invoices are included in the proper period.

Exhibit G
Capital Leases and Disposals

During our audit procedures related to capital leases, it was noted the useful life assigned to an asset under capital lease for amortization purposes was longer than the actual lease term. This difference causes a variance between the asset and liability portions of the lease. The variance is considered to be insignificant to the consolidated financial statements.

Although the variance is insignificant, we that recommend management review the lease contract term when setting up the capital asset in the fixed asset system. This will ensure these items are recorded in compliance with generally accepted accounting principles.

We also noted that the Hospital has not had any fixed asset disposals in the past two years. We recommend a review of your current lapse schedules to identify any items that are no longer at the Hospital which should be removed from the records.

Exhibit H
IRS Form 990 Changes

The Internal Revenue Service has recently released the new Form 990, which is the annual return that not-for-profit organizations are required to file. The Hospital and all subsidiaries will be required to file this new form for the year ending December 31, 2008. The new Form 990 format includes the introduction of Schedule H, which tax-exempt hospitals must use to demonstrate community benefit, including charity care, governmental program underpayment, bad debts, and various other community benefits.

The new Form 990 also requires expanded disclosure of executive compensation, including methods used to set executive compensation, as well as disclosure of fringe benefits and perks to executives.

In addition, there will be expanded reporting on compliance with tax-exempt bond issues, including arbitrage calculations, as part of the annual filing.

The new Form 990 requires significantly more information than has been filed in the past. This information will require significant efforts in accumulating various policies, information on bond issues, and community benefit information. The Hospital and all subsidiaries should become familiar with these new requirements and begin accumulating the required information. Additionally, since there are many questions on the new forms that address the existence of numerous policies and since the answers to these policy questions will be open to public scrutiny, the Hospital should consider conducting a detail "inventory" of the policies addressed on the form and the possibility of implementing or revising policies where appropriate.

Exhibit I
403(b) Plans - New Audit Requirement

The Department of Labor recently finalized revisions to the 2009 Form 5500. The revised Form 5500 will require many previously unaudited 403(b) plans to be audited. Currently, there are no Form 5500 filing requirements or a limited filing requirement for 403(b) plans (depending on certain facts and circumstances). The filing, if any, for a 403(b) plan does not require an audit or required schedules. During the past few years, the Internal Revenue Service and Department of Labor have identified problems with 403(b) plans and thus determined a change was needed.

Beginning with the 2009 plan year, organizations subject to the Employee Retirement Income Security Act of 1974 (ERISA) will generally be required to have their 403(b) plan's financial statements audited, if they have more than 100 eligible participants as of the beginning of the plan year. These audited financial statements will be a required attachment to the plan's Form 5500.

Although the first audit is not required until the 2009 plan year, the Form 5500 requires the statement of net assets be fully comparative. Thus, the 2008 financial information will need to be included in the plan's 2009 audited financial statements.

Engagement Scope

Our audit plan represented an approach responsive to the assessment of risk for Three Rivers Health. Specifically, we designed our audit to:

- Express an opinion on the December 31, 2007 consolidated financial statements of the Hospital
- Issue a management letter that provides our recommendations regarding internal controls and opportunities for improvement or efficiency, based on observations made during the course of our audit
- Issue the required communications under SAS 114 to assist the board in overseeing management's financial reporting and disclosure process

Required Communications

Statement on Auditing Standards No. 114 (as amended) and other professional standards require the auditor to communicate certain matters to the board that may assist the board in overseeing management's financial reporting and disclosure process. Below, we summarize these required communications as they apply to the Hospital.

Area	Comments
Auditors' Responsibilities Under Generally Accepted Auditing Standards (GAAS) Management has the responsibility for adopting sound accounting policies, for maintaining an adequate and effective system of accounts, for the safeguarding of assets, and for devising an internal control structure that will, among other things, help ensure the proper recording of transactions. The transactions that should be reflected in the accounts and in the consolidated financial statements are matters within the direct knowledge and control of management. Our knowledge of such transactions is limited to that acquired through our audit. Accordingly, the fairness of representations made through the consolidated financial statements is an implicit and integral part of management's responsibility. We may make suggestions as to the form or content of the consolidated financial statements or even draft them, in whole or in part, based on management's accounts and records. However, our responsibility for the consolidated financial statements is confined to the expression of an opinion on them. The consolidated financial statements are the responsibility of management. Our audit was designed in accordance with auditing standards generally accepted in the United States of America to provide reasonable, rather than absolute, assurance that the consolidated financial statements are free of material misstatement. As a part of our audit, we obtained an understanding of internal control sufficient to plan our audit and to determine the nature, timing, and extent of testing performed. However, we were not engaged to and we did not perform an audit of internal control over financial reporting. HIPAA and corporate compliance testing are beyond the scope of a financial statement audit.	We have issued an unqualified opinion on the consolidated financial statements of the Hospital for the year ended December 31, 2007.
Materiality The concept of materiality is inherent in the work of an independent auditor.	An auditor places greater emphasis on those items that have, on a relative basis, more importance to the consolidated financial statements and greater possibilities of material error than with those items of lesser importance or those in which the possibility of material error is remote.
Critical Accounting Policies and Practices Auditing standards call for us to inform you regarding the initial selection of, and change in, significant accounting policies or their application. In addition, we are expected to inform you about the methods used to account for significant unusual transactions and the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.	None

Area	Comments
Organization's Accounting Principles We describe our judgments about the quality and acceptability of the accounting policies as applied in the Hospital's financial reporting, including the consistency of the accounting policies and their application related to the consolidated financial statements and disclosures.	Management followed a consistent methodology with the prior year related to the establishment and maintenance of accounting policies and the related application of such policies in the preparation of consolidated financial statements. We believe the underlying methodology used by the Hospital is reasonable.
Accounting Estimates Accounting estimates are an integral part of the consolidated financial statements prepared by management and are based on management's current judgments. Auditing standards call for us to report to you on accounting estimates that are particularly sensitive because of their significance to the consolidated financial statements or because of the possibility that future events affecting them may differ markedly from management's current judgments. Further, we are expected to report to you about the process used by management in formulating particularly sensitive accounting estimates and about the basis for our conclusions regarding the reasonableness of those estimates.	We have provided additional information in the section titled "Areas of Audit Emphasis." The areas of particular significance include: • Net realizable value of patient accounts receivable (contractual and bad debt allowances) • Third-party payor settlements • Professional liability claims
The Adoption of, or a Change in, an Accounting Principle We communicate to the board the initial selection of, and any changes in, significant accounting principles or their application when the accounting principle or its application, including alternative methods of applying the accounting principle, has a material effect on the consolidated financial statements.	None
Significant or Unusual Transactions and Controversial or Emerging Areas We communicate to the board the methods used to account for significant unusual transactions and the effects of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.	None
Significant Audit Adjustments Auditing standards call for us to report to you significant audit adjustments that, in our judgment, may not have been detected except through the auditing procedures we performed. We communicate to the board the information about adjustments arising from the audit (whether recorded or not) that could, in our judgment, either individually or in the aggregate, have a significant effect on the Hospital's consolidated financial statements.	None
Uncorrected Possible Financial Statement Adjustments Considered by Management to be Immaterial Auditing standards also require us to inform the board about uncorrected possible financial statement adjustments identified by us during the current engagement and pertaining to the latest period presented, which were determined by management to be immaterial, both individually and in the aggregate, to the consolidated financial statements taken as a whole.	There were three unrecorded possible financial statement adjustments identified. First, an invoice totaling $45,446 was improperly excluded from payables and expenses in 2007. This entry would increase expenses and increase payables. Second, amortization on capital leases was understated by $87,044. This entry would increase amortization expense and reduce fixed assets. Lastly, accrued payroll was overstated by $101,887. This entry would reduce payroll-related expenses and reduce accrued liabilities.

Area	Comments
Fraud and Illegal Acts We report to the board fraud and illegal acts involving senior management and fraud and illegal acts (whether caused by senior management or other employees) that cause a material misstatement of the consolidated financial statements.	We are not aware of any matters that require communication.
Material Weaknesses in Internal Control We are required to communicate all material weaknesses in internal control which may have been identified during the course of our audit.	In connection with our audit of the Hospital, we reviewed internal controls for the purposes of obtaining a sufficient understanding of internal control to plan the audit and to determine the nature, timing, and extent of tests to be performed, during which no material weaknesses were identified. However, we were not engaged to, and we did not, perform audits of internal control over financial reporting.
Other Information in Documents Containing Audited Consolidated Financial Statements	None
Disagreements with Management on Financial Reporting Matters	None
Serious Difficulties Encountered in Dealing with Management when Performing the Audit	None
Major Issues Discussed with Management in Connection with Initial Retention	None
Consultation with Other Accountants	We are not aware of any consultations with other accountants.
Other Material Written Communications with Management	Material written communications include various documents, including these communications. Some of the other significant written communications include the following: • Engagement letter between Three Rivers Health and Plante & Moran • Management representation letter
Independence We are required to communicate, at least annually, the following to the board of directors of the Hospital: • Disclose, in writing, all relationships between Plante & Moran and the Hospital that, in our professional judgment, may reasonably be thought to bear on independence • Confirm in writing that, in our professional judgment, we are independent of the Hospital • Discuss with the board any matters that in our professional judgment may reasonably be thought to bear on our independence	We are not aware of any relationships between Plante & Moran and the Hospital that, in our professional judgment, may reasonably be thought to bear on our independence. Related to our audit of the consolidated financial statements of the Hospital as of December 31, 2007 and for the year then ended, we are independent certified public accountants with respect to the Hospital within the meaning of the applicable published pronouncements of the Independence Standards Board and under Rule 101 of the American Institute of Certified Public Accounts' Code of Professional Conduct, its interpretations, and rulings.

Areas of Audit Emphasis

Key areas of audit emphasis and our judgments about the quality, not just the acceptability, of the Hospital's accounting principles as applied in its financial reporting are summarized in the table below.

Area	Accounting Policy	Judgments and Sensitive Estimates	Comments on Quality of Accounting Policy and/or Application
Net Realizable Value of Patient Accounts Receivable	The Hospital maintains accounting policies and procedures specifically related to these accounts adjusting amounts to reflect estimated amounts recoverable from patients and third-party payors based on paid claims experience.	Required allowances, reflecting the difference between standard rates and reimbursement, are based on aging and historical payment experience while considering current trends. Balance sheet valuation allowances are established for potential payment dis-allowances.	Management followed a consistent methodology with the prior year related to the establishment of allowances for doubtful accounts and contractual adjustments. We believe the underlying methodology used by the Hospital is reasonable.
Estimated Settlements with Third-party Payors	The Hospital establishes current year estimates of cost reports to be filed based on current year data and prior year cost report relationships. Estimates of prior year settlements are updated as additional information (including filed cost reports and interim settlements) become available.	These accounts represent amounts due to Medicare and other payors for the settlement of outstanding cost reports and amounts due to other payors for contract issues. Laws and regulations are complex and these estimates may change by a material amount in the near term. Changes to these amounts will be reflected in the statement of operations in the year of the change.	We believe the underlying methodology used by the Hospital is reasonable.
Professional Liability Claims	The Hospital establishes an estimate of the ultimate expense based on conclusions reached by the in-house risk manager, legal counsel, and ongoing discussions related to incidents and reported claims with the Hospital's insurance carrier.	Estimates recorded by the Hospital are dependent upon underlying methods and analysis used by the insurance carrier and the accuracy of the underlying data.	Management has accrued its best estimate of these potential losses to the extent they fall within the limits of the insurance program or exceed the limits of insurance coverage. The loss reserve also includes estimates for claims and related legal expenses from unreported incidents arising from services provided to patients. We believe the underlying assumptions used by management and the resultant amounts are reasonable.

In addition, other areas of audit emphasis included:

- Cash and other investments
- Fixed asset accounting and the applicable depreciation
- Debt and related testing of compliance with covenants

Healthcare Landscape

In planning and performing our audit of the consolidated financial statements of the Hospital for the year ended December, 2007, we considered the overall accounting practices of the Hospital as well as the risks the Hospital is facing. The purpose of this section is to address some of these risks.

Reimbursement Update

Medicare Reimbursement - Fiscal Year 2007

- Average increase in inpatient payments of 3.5 percent
- Modification of new DRG payment rates. Modifications will be implemented over a three-year period.

Medicare Reimbursement - Fiscal Year 2008

The organizations for Medicare and Medicaid Services (CMS) released the final rules addressing updates to Medicare reimbursement effective October 1, 2007. Following is a brief summary of some of the proposed changes:

- Overhaul of the DRG classification system - Expanding the number of DRGs from 538 to 745
- Market basket increase of 3.3 percent; however, much of the increase will be negated by anticipated reductions in organization case mix as a result of revamping the DRG system and a 1.2 percent reduction for project "behavioral" changes
- Organizations that fail to submit quality data required under the Deficit Reduction Act of 2005 would receive an update that is 2.0 percent less than market basket
- Capital rates for urban organizations would be frozen and rural organizations would receive a .8 percent increase in capital payment rates

Medicare Physician Reimbursement - Ruling for Calendar Year 2008

Proposed calendar year 2008 rules call for payment for physician services to decrease 9.9 percent. This proposed decrease was later reversed and replaced with a .5 percent increase effective January 1, 2008. Physician payments from Medicare have experienced little or no increases over the past several years.

Pay-for-performance

Quality of care improved in all five clinical areas measured as part of a recent pay-for-performance demonstration project conducted by CMS. In the project, the Premier Organization Quality Incentive, participating organizations were awarded $8.85 million in bonus payments for showing measurable improvements in quality of care. The bonus payments were awarded based on relevant quality measures. It is clear that Medicare will continue moving forward on pay-for-performance initiatives.

Reimbursement Update (Continued)

Medicare Corporation Insurance Trust Financial Update

In a report issued in May 2006, the trustees for the federal Medicare program estimated the program's corporation insurance fund will be exhausted in 2018, two years earlier than projected in 2005. Highlights of the report include:

- The Part A trust fund is projected to grow an average of 7.1 percent per year over the next 10 years
- The Part B expenditures have increased 10.6 percent per year over the past six years.
- The difference between Medicare expenditures and dedicated revenue will exceed 45 percent of total Medicare outlays in 2012, triggering an "excess general revenue Medicare funding" determination.
- Under the Medicare Modernization Act, if a second determination is made in the next year, then a "Medicare funding warning" would be made requiring the president to require Congress to consider legislation to curb (i.e., cut) Medicare spending in the next budget cycle.

GAO Advises Incoming Congress to Reform Medicare and Medicaid

In a letter to congressional leaders in November 2006, the Government Accountability Office (GAO) Comptroller General urged Congress to reform Medicare and Medicaid and to improve their integrity and sustainability. The letter noted that Medicare's and Medicaid's long-term fiscal sustainability are in jeopardy, adding that Medicare's "size and complexity makes it vulnerable to improper payments and inefficient payment systems," while Medicaid is at risk of "increased and inappropriate federal spending." The GAO suggested that Congress modernize Medicare payment policies to reward quality and efficiency and assess the corporations for Medicare and Medicaid services' managerial oversight of both programs. In addition, the letter recommended Congress reform Medicaid to prevent states from inappropriately obtaining federal matching funds by "limiting Medicaid payments to government facilities to the costs of providing services" and make sure that all efforts to restructure Medicaid eligibility and benefits are budget neutral.

Office of Inspector General News

Physician Recruitment

OIG provides safe harbors on physician recruitment for corporations designated in a health professional shortage area (HPSA). Information on HPSA can be found at the following website: bphc.hrsa.gov.

OIG Reports on 2006 Achievements

For fiscal year (FY) 2006, the HHS Office of Inspector General (OIG) reported savings and expected recoveries of nearly $38.2 billion for federal healthcare programs: $35.8 billion in implemented recommendations and other actions to put funds to better use, $789.4 million in audit receivables, and $1.6 billion in investigative receivables. Also for FY 2006, OIG reported exclusions of 3,425 individuals and entities for fraud or abuse involving federal healthcare programs and/or their beneficiaries; 472 criminal actions against individuals or entities that engaged in crimes against departmental programs; and 272 civil actions, which include False Claims Act (FCA) and unjust enrichment suits filed in federal district court, civil monetary penalties law (CMPL) settlements, and administrative recoveries related to provider self-disclosure matters. Source: OIG Semiannual Report, December 5, 2006.

Highlights of OIG's 2008 Work Plan

The following items have been highlighted in OIG's 2008 Work Plan:

- Corporation capital payments
- Medicare-dependent corporation program testing
- Medicare disproportionate share payments
- Provider bad debts
- Compliance with Medicare transfer policy
- Inpatient wage index
- Inpatient payments for new technologies
- Medicare secondary payer
- Medical appropriateness and coding of DRGs
- Inappropriate payments for diagnostic x-ray in corporation emergency rooms
- Oversight of Joint Commission Corporation Accreditation process
- Place of services errors
- Medicare payments for selected physician services
- Appropriateness of Medicare payments for polysomnography
- Assignment rules by Medicare providers
- Geographic areas with high utilization of ultrasound services
- Physician reassignment of benefits

Other Developments

Corporations Can Share Health IT with Physicians

In an Internal Revenue Service (IRS) ruling issued in early May 2007, the IRS noted that sharing health information technology with physicians would not jeopardize a not-for-profit corporation's tax-exempt status. Under this ruling, the following requirements must be met:

- Electronic health record arrangement requires that the corporation and the physician comply with electronic health record regulations issued by the Department of Health and Human Services.
- The arrangement must grant to the corporation, as permitted by the law, access to all electronic medical records created by the physician.
- Participation must be open to all of the corporation's medical staff physicians.
- The corporation must provide the same level of subsidy to all of its medical staff physicians unless the level of the subsidy is related to the difference in the healthcare needs of the community and not based on differences in referrals.

IRS Initiative Targets Not-for-profit Compensation Practices

Under the new Tax-exempt Compensation Enforcement Project, the IRS will be requesting information from approximately 2,000 charities and foundations to review information and supporting documents on compensation practices and policies for specific executives. The IRS will also be reviewing insider transactions such as leasing arrangements to officers and others in the corporation.

Community Benefit

Numerous activities continue to take place relative to the focus on demonstrating community benefit for not-for-profit healthcare providers. Initiatives range from IRS focus in audits, to proposed state and federal legislation. Key areas of continued focus is:

- Minimum levels of charity care
- Enhance pricing transparency
- Limitation on charge levels to the uninsured

Uncompensated Care Update

United States corporations provided $28.8 billion in uncompensated care in 2005, up from $26.9 billion, or 7.1 percent from 2004. Since 2000, uncompensated care has increased 25 percent or $5.3 billion. The survey, issued by American Corporation Association, is valued at cost of providing services for all bad debts and charity care and does not include amounts of Medicare and Medicaid reimbursement which are below the cost of providing services to Medicare and Medicaid participants. According to the survey, Medicare and Medicaid underpaid corporations by $15.5 billion and $9.8 billion, respectively.

Accounting and Auditing Update

New Accounting Standards

Health Care Audit Guide - The AICPA Health Care task force is currently evaluating the Health Care Audit Guide as part of a comprehensive overhaul of the 1996 document. A draft of the guide is expected to be released for comments possibly in 2008. Key areas to be addressed include: charity care reporting, accounting and reporting of derivatives, contributions, medical malpractice, accounting for transfers between unrelated corporations, and new basic financial statement presentations.

Other New Accounting Rules are as Follows:

FSP FAS 126-1 - Defines a "public" not-for-profit entity to include an entity on whose behalf a governmental entity has issued tax-exempt bonds (finance authority). This requires certain additional disclosures to be made in the consolidated financial statements.

SFAS 133 Implementation Guide Issue No. G26 - Provides additional guidance on accounting for hedging instruments for interest rates or cash flows (interest rate swaps). Hedges against variability in interest rates can only use hedge accounting if the swaps are based on the same benchmark index (LIBOR or Treasury obligations).

Business Combinations (Exposure Draft) - The new rules essentially eliminate "pooling of interest" accounting recognition for mergers. All business combinations would be required to use the "acquisition method" (formerly "purchase method") of accounting. Under the new rules the fair market value of all assets acquired and liabilities assumed is computed. If assets exceed the liabilities assumed and consideration paid, a contribution is recognized by the acquirer. If the consideration and liabilities assumed exceeds the market value of the assets, goodwill is recognized. These rules could be effective in 2008.