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STATE OF INDIANA

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March 25, 2010

Board of Directors
Dunn Memorial Hospital
1600 23rd Street
Bedford, Indiana 47421

We have reviewed the audit report prepared by Blue & Company, LLC, Independent Public Accountants, for the period January 1, 2008 to December 31, 2008. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Dunn Memorial Hospital, as of December 31, 2008 and the results of its operations for the period then ended, on the basis of accounting described in the report.

The Independent Public Accountants' report is filed with this letter in our office as a matter of public record.

STATE BOARD OF ACCOUNTS

DUNN MEMORIAL HOSPITAL

COMBINED FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

CPAs / ADVISORS

blue

DUNN MEMORIAL HOSPITAL

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Dunn Memorial Hospital
Bedford, Indiana

We have audited the accompanying combined balance sheets of Dunn Memorial Hospital (Hospital) and its discretely presented component unit, collectively a component unit of Lawrence County, as of December 31, 2008 and the related combined statement of revenues, expenses and changes in net assets and cash flows for the year then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined financial statements based on our audits. The prior year summarized comparative information has been derived from the Center's 2007 financial statements and, in our report dated January 16, 2009; we expressed an unqualified opinion on those financial statements.

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

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of the Hospital as of December 31, 2008, and the combined results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Board of Trustees
Dunn Memorial Hospital
Bedford, Indiana

Management's discussion and analysis on pages i through v are not a required part of the basic combined financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Blue & Co., LLC

October 14, 2009

REQUIRED SUPPLEMENTARY INFORMATION

This section of Dunn Memorial Hospital's (Hospital) annual combined financial statements presents background information and management's discussion and analysis of the Hospital's financial performance during the year ended December 31, 2008. This MD&A includes a discussion and analysis of the activities and results of the Hospital only and does not include the Hospital's discrete component unit. Please read this MD&A in conjunction with the Hospital's combined financial statements that follow.

FINANCIAL HIGHLIGHTS

- The Hospital reported a decrease in net assets of approximately $1,503,000 and $2,320,000 for the year ended 2008 and 2007 respectively.

USING THIS ANNUAL REPORT

The Hospital's combined financial statements consist of three statements – a balance sheet, a statement of revenues, expenses and changes in net assets, and a statement of cash flows. These financial statements and related notes provide information about the activities and the financial position of the Hospital.

The balance sheet includes all of the Hospital's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to Hospital creditors (liabilities).

All of the current year revenue earned and expenses incurred are accounted for in the statement of revenues, expenses and changes in net assets.

Finally, the statement of cash flows purpose is to provide information about the Hospital's cash flows from operating activities, financing activities including capital additions, and investing activities. This statement provides information on the sources and uses of cash as well as the change in cash balance during the year.

THE HOSPITAL'S NET ASSETS

Assets, Liabilities, and Net Assets

	2008	2007	Change
Assets			
Current assets	$ 12,136,175	$ 13,110,977	$ (974,802)
Capital assets, net	18,589,762	19,410,996	(821,234)
Assets whose use is limited	112,215	108,082	4,133
Other assets	1,243,082	1,083,978	159,104
Total assets	$ 32,081,234	$ 33,714,033	$ (1,632,799)
Liabilities			
Current liabilities	$ 6,630,428	$ 13,531,146	$ (6,900,718)
Long-term debt	7,446,381	675,854	6,770,527
Total liabilities	14,076,809	14,207,000	(130,191)
Net assets			
Invested in capital assets, net of related debt	10,869,897	11,138,614	(268,717)
Unrestricted	7,134,528	8,368,419	(1,233,891)
Total net assets	18,004,425	19,507,033	(1,502,608)
Total liabilities and net assets	$ 32,081,234	$ 33,714,033	$ (1,632,799)

Capital assets, net decreased primarily due to depreciation expense exceeding capital asset additions. Assets whose use is limited increased primarily as a result of interest gained on CD investments. Current liabilities decreased by $7,020,000 due to short-term bank obligations that were refinanced as long-term debt subsequent to year-end. The Hospital used derivatives to manage financial risks related to interest rate movements and the effects on its cash flows. The Hospital's derivative was an interest rate swap. The hedging instrument expired in February 2009.

OPERATING RESULTS AND CHANGES IN THE HOSPITAL'S NET ASSETS

Operating Results and Changes in Net Assets

	2008	2007	Change
Operating revenue			
Net patient service revenue	$ 36,411,946	$ 36,381,807	$ 30,139
Other operating revenue	1,520,522	1,164,925	355,597
Total operating revenue	37,932,468	37,546,732	385,736
Operating expenses			
Salaries and benefits	23,024,579	22,852,767	171,812
Purchased services and professional fees	4,638,494	4,580,576	57,918
Depreciation and amortization	2,242,471	2,783,802	(541,331)
Other operating expenses	9,136,266	9,115,863	20,403
Total operating expenses	39,041,810	39,333,008	(291,198)
Operating loss	(1,109,342)	(1,786,276)	676,934
Nonoperating revenue (expense)	(278,714)	(507,285)	228,571
Change in net assets before discontinued operations	(1,388,056)	(2,293,561)	905,505
Loss from operations of discontinued component	(114,552)	(26,602)	(87,950)
Change in net assets	(1,502,608)	(2,320,163)	817,555
Net assets beginning of year	19,507,033	21,827,196	(2,320,163)
Net assets end of year	$ 18,004,425	$ 19,507,033	$ (1,502,608)

SOURCES OF REVENUE

During 2008, the Hospital derived substantially all of its revenue from patient service and other related activities. A significant portion of the patient service revenue is from patients that are insured by government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. Revenue from the Medicare and Medicaid programs accounted for approximately 37 percent and 1 percent, respectively, of the Hospital's net patient revenue for the year ended 2008.

OPERATING AND FINANCIAL PERFORMANCE

The Hospital's 2008 return on net assets was (8.3%), compared to (11.9%) for 2007.

The following section highlights the major financial factors for 2008:

- The Hospital's admissions declined from 1,959 in 2007 to 1,586 in 2008 while the Hospital's adjusted patient days decreased to 20,065 in 2008, compared to 25,728 in 2007.

- The Hospital's net patient service revenue increased approximately $30,100 during 2008, a .1% increase over 2007.

- Operating expenses decreased approximately $291,200 or 0.7%. The growth is attributable to the need for additional resources to provide services to the Hospital's patient volumes.

CAPITAL ASSETS

The change in capital assets is outlined in the following table:

	2008	2007	Change
Land	$ 746,488	$ 750,982	$ (4,494)
Land improvements	828,492	825,755	2,737
Buildings and improvements	27,124,052	26,293,486	830,566
Equipment	29,624,330	29,225,040	399,290
Construction in progress	572,031	402,687	169,344
Total capital assets	58,895,393	57,497,950	$ 1,397,443
Less accumulated depreciation	40,305,631	38,086,954	2,218,677
Capital assets, net	$ 18,589,762	$ 19,410,996	$ (821,234)

Capital assets have increased due to the continued growth in patient service demands. As previously mentioned the Hospital continues to increase space and equipment resources to meet the needs of the community. The Hospital continually evaluates facilities and equipment to ensure that everything is upgraded as necessary.

DEBT

See the notes to the combined financial statements for disclosure of the use of a bank letter of credit to pay off the 2003 revenue bonds. The Hospital also entered into a Forbearance Agreement with Fifth Third bank, which expired in May 2009. The Hospital then obtained long-term financing through the issuance of Revenue Bonds issued by the Indiana Bond Bank, which are guaranteed by the County. At December 31, 2008, the following are the sources of debt the Hospital has in place.

- Line of credit
- 2009 revenue bonds
- Capital lease obligations

More detailed information about the Hospital's long-term debt is presented in the Notes to the Combined Financial Statements.

ECONOMIC OUTLOOK

Management believes that the healthcare industry's and the Hospital's operating margins will continue to be under pressure as a result of the changes in payor mix and growth in operating expenses, that exceed any increases in contractually arranged and legally established payments received for services provided. Another factor that poses a challenge to management is the increasing competitive market for the delivery of healthcare services. This competitive market challenge will potentially be offset by the expected growth in our service area. The Hospital will still be faced with the challenge of providing quality services in an increasingly competitive environment, while at the same time managing costs. The Hospital will be affected by the increases in labor costs due to the competition for healthcare workers.

CONTACTING THE HOSPITAL'S FINANCIAL MANAGEMENT

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital business administration by telephoning 812-275-3331.

DUNN MEMORIAL HOSPITAL

COMBINED BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

ASSETS

	2008			
	Hospital	Foundation	Total reporting entity	With comparative totals for 2007
Current assets				
Cash and cash equivalents	$ 1,560,468	$ 10,483	$ 1,570,951	$ 3,120,371
Restricted cash	3,700,000	-0-	3,700,000	-0-
Investments	-0-	334,159	334,159	492,314
Patient accounts receivable, less allowance for uncollectible accounts of $4,229,976 in 2008 and $4,861,823 in 2007	5,351,717	-0-	5,351,717	7,113,916
Other receivables	223,941	-0-	223,941	215,567
Estimated third-party settlements	99,947	-0-	99,947	1,274,994
Other current assets	1,200,102	1,276	1,201,378	1,408,631
Total current assets	12,136,175	345,918	12,482,093	13,625,793
Assets whose use is limited				
Board designated funds				
Investments	112,215	-0-	112,215	108,082
Total assets whose use is limited	112,215	-0-	112,215	108,082
Capital assets				
Land	746,488	-0-	746,488	750,982
Construction in progress	572,031	-0-	572,031	402,687
Depreciable capital assets, net	17,271,243	-0-	17,271,243	18,257,327
	18,589,762	-0-	18,589,762	19,410,996
Other assets	1,243,082	-0-	1,243,082	1,083,978
Total assets	$ 32,081,234	$ 345,918	$ 32,427,152	$ 34,228,849

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

	2008			With comparative totals for 2007
	Hospital	Foundation	Total reporting entity	
Current liabilities				
Notes payable	$ 673,808	$ -0-	$ 673,808	$ 498,699
Current portion of capital leases and LTD	281,228	-0-	281,228	7,596,528
Accounts payable	3,877,498	6,196	3,883,694	3,594,958
Salaries, wages and related payables	1,470,654	-0-	1,470,654	1,400,355
Other current liabilities	327,240	-0-	327,240	451,863
Total current liabilities	6,630,428	6,196	6,636,624	13,542,403
Noncurrent liabilities				
Deriviative liability	7,744	-0-	7,744	991
Long-term debt obligations	7,020,000	-0-	7,020,000	-0-
Long-term capital lease obligations	418,637	-0-	418,637	674,863
Total noncurrent liabilities	7,446,381	-0-	7,446,381	675,854
Total liabilities	14,076,809	6,196	14,083,005	14,218,257
Net assets				
Invested in capital assets, net of related debt	10,869,897	-0-	10,869,897	11,139,605
Unrestricted	7,134,528	339,722	7,474,250	8,870,987
Total net assets	18,004,425	339,722	18,344,147	20,010,592
Total liabilities and net assets	$ 32,081,234	$ 345,918	$ 32,427,152	$ 34,228,849

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008				With comparative totals for 2007
	Hospital	Foundation	Eliminations	Total reporting entity	
Revenue					
Net patient service revenue	$ 36,411,946	$ -0-	$ -0-	$ 36,411,946	$ 36,381,807
Other	1,520,522	62,480	(30,566)	1,552,436	1,231,427
Total operating revenue	37,932,468	62,480	(30,566)	37,964,382	37,613,234
Operating expenses					
Salaries and wages	18,917,057	-0-	-0-	18,917,057	18,951,175
Employee benefits	4,107,522	-0-	-0-	4,107,522	3,901,592
Purchased services and professional fees	4,638,494	-0-	-0-	4,638,494	4,580,576
Supplies and other	8,486,192	92,553	(62,473)	8,516,272	8,580,417
Insurance	650,074	-0-	-0-	650,074	586,962
Depreciation and amortization	2,242,471	-0-	-0-	2,242,471	2,783,802
Total operating expenses	39,041,810	92,553	(62,473)	39,071,890	39,384,524
Operating loss from continuing operations	(1,109,342)	(30,073)	31,907	(1,107,508)	(1,771,290)
Nonoperating income (expenses)					
Investment income	102,719	(133,764)	-0-	(31,045)	56,429
Non-capital contributions	46,201	-0-	(31,907)	14,294	100
Gain on disposal of capital assets	4,106	-0-	-0-	4,106	-0-
Interest expense	(431,740)	-0-	-0-	(431,740)	(543,860)
Total nonoperating income (expenses), net	(278,714)	(133,764)	(31,907)	(444,385)	(487,331)
Change in net assets before discontinued operations	(1,388,056)	(163,837)	-0-	(1,551,893)	(2,258,621)
Loss from operations of discontinued component	(114,552)	-0-	-0-	(114,552)	(26,602)
Change in net assets	(1,502,608)	(163,837)	-0-	(1,666,445)	(2,285,223)
Net assets					
Beginning of year	19,507,033	503,559	-0-	20,010,592	22,295,815
End of year	$ 18,004,425	$ 339,722	$ -0-	$ 18,344,147	$ 20,010,592

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008				With comparative totals for 2007
	Hospital	Foundation	Eliminations	Total reporting entity	
Operating activities					
Cash received from patient services	$ 39,349,192	$ -0-	$ -0-	$ 39,349,192	$ 36,558,062
Cash paid for salaries, wages and benefits	(22,954,280)	-0-	-0-	(22,954,280)	(22,752,017)
Cash paid to vendors and suppliers	(13,403,979)	(91,968)	-0-	(13,495,947)	(12,272,013)
Other receipts and payments, net	1,511,399	62,480	31,907	1,605,786	1,446,994
Net cash flows from operating activities	4,502,332	(29,488)	31,907	4,504,751	2,981,026
Non-capital financing activities					
Change in physician receivables	(170,098)	-0-	-0-	(170,098)	3,779
Non-capital contributions	46,201	-0-	(31,907)	14,294	100
Net cash flows from non-capital financing activities	(123,897)	-0-	(31,907)	(155,804)	3,879
Capital and related financing activities					
Proceeds from note payable	7,630,000	-0-	-0-	7,630,000	578,220
Payments on note payable	(434,891)	-0-	-0-	(434,891)	(200,000)
Proceeds from long-term debt	13,020	-0-	-0-	13,020	-0-
Payments on long-term debt	(7,659,546)	-0-	-0-	(7,659,546)	(667,868)
Interest on long-term debt	(428,305)	-0-	-0-	(428,305)	(509,576)
Proceeds from the sale of capital assets	8,100	-0-	-0-	8,100	-0-
Loss from discontinued operations	(114,552)	-0-	-0-	(114,552)	(26,602)
Purchase of capital assets	(1,338,488)	-0-	-0-	(1,338,488)	(530,557)
Net cash flows from capital and related financing activities	(2,324,662)	-0-	-0-	(2,324,662)	(1,356,383)
Investing activities					
Investment income	102,719	(133,764)	-0-	(31,045)	56,429
Other nonoperating income	3,318	-0-	-0-	3,318	19,747
Other changes in assets whose use is limited and investments	(4,133)	158,155	-0-	154,022	(39,312)
Net cash flows from investing activities	101,904	24,391	-0-	126,295	36,864
Net change in cash and cash equivalents	2,155,677	(5,097)	-0-	2,150,580	1,665,386
Cash and cash equivalents					
Beginning of year	3,104,791	15,580	-0-	3,120,371	1,454,985
End of year	$ 5,260,468	$ 10,483	$ -0-	$ 5,270,951	$ 3,120,371
Reconciliation of cash and cash equivalents to the balance sheets					
Cash and cash equivalents					
In current assets	$ 1,560,468	$ 10,483	$ -0-	$ 1,570,951	$ 3,120,371
Restricted cash	3,700,000	-0-	-0-	3,700,000	$ -
Total cash and cash equivalents	$ 5,260,468	$ 10,483	$ -0-	$ 5,270,951	$ 3,120,371

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008				2007
	Hospital	Foundation	Eliminations	Total reporting entity	Total reporting entity (Memorandum only)
Reconciliation of operating income to net cash flows from operating activities					
Operating loss from continuing operations	$ (1,109,342)	$ (30,073)	$ 31,907	$ (1,107,508)	$ (1,771,290)
Adjustments to reconcile operating loss from continuing operations to net cash flows from operating activities					
Depreciation and amortization	2,242,471	-0-	-0-	2,242,471	2,783,802
Provision for bad debts	4,538,755	-0-	-0-	4,538,755	3,407,315
Changes in operating assets and liabilities					
Patient accounts receivable	(2,776,556)	-0-	-0-	(2,776,556)	(4,428,246)
Other receivables	(8,374)	-0-	-0-	(8,374)	167,705
Estimated third-party payor settlements	1,175,047	-0-	-0-	1,175,047	1,197,186
Other current assets	201,607	5,646	-0-	207,253	64,275
Other assets	(749)	-0-	-0-	(749)	-0-
Accounts payable	293,797	(5,061)	-0-	288,736	1,026,451
Salaries, wages and related payable	70,299	-0-	-0-	70,299	100,750
Other current liabilities	(124,623)	-0-	-0-	(124,623)	433,078
Net cash flows from operating activities	$ 4,502,332	$ (29,488)	$ 31,907	$ 4,504,751	$ 2,981,026
Supplemental cash flows information					
Cash paid for interest	$ 428,305	$ -0-	$ -0-	$ 428,305	$ 526,727
Noncash capital and related financing activities					
Capital lease obligation incurred for use of equipment	$ 75,000	$ -0-	$ -0-	$ 75,000	$ 287,973

See accompanying notes to combined financial statements.

1. SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Dunn Memorial Hospital (Hospital) is an acute-care hospital located in Bedford, Indiana. The Hospital is a component unit of Lawrence County (County) and the Board of County Commissioners appoints members of the Board of Trustees of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Lawrence County area. It also operates a home health agency in the same geographic area.

On July 14, 1978, the Board of County Commissioners of Lawrence County, upon written request of the Hospital Board of Trustees, created the Dunn Memorial Hospital Association (Association). The Association was created pursuant to the provisions of Indiana Code 16-22-6 for the exclusive purpose of financing the constructing hospital facilities for the Hospital. Accordingly, the transactions of the Association are combined with the Hospital.

For financial purposes, the Hospital's reporting entity consists of the primary government and the component unit organization for which the nature and significance of its relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete, and it is financially accountable to the primary government (discrete component unit).

Discrete Component Unit

Discretely presented component units are reported in a separate column in the combined financial statements to emphasize they are legally separate from the primary government. They are financially accountable to the primary government, or have relationships with the primary government such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The discretely presented component unit is:

Dunn Memorial Foundation, Inc. (Foundation): A separate not-for-profit entity organized to support the operations of the Hospital. All significant transactions between the Hospital and the Foundation have been eliminated. Complete financial statements of the Foundation may be obtained from its Administrative Office at 1616 23rd St, Bedford, IN 47421.

Use of Estimates

The preparation of combined 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 combined financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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 Funds and Other Governmental Entities That Use 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.
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Risk Management

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

Cash and Cash Equivalents

Cash and cash equivalents include all cash held in checking, savings and money market accounts available for operating purposes with original maturity dates of 90 days or less from the date of purchase. The Hospital maintains its cash in accounts, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on cash and cash equivalents.

Investments

Investments are reported at fair value, as determined by quoted market prices. Interest, dividends, and gains and losses, both realized and unrealized, on investments are included in nonoperating revenue when earned.

Patient Accounts Receivable and Net Patient Service Revenue

Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated adjustments under reimbursement agreements. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

The Hospital is a provider of services to patients entitled to coverage under Medicare. The Hospital was granted Critical Access Status by Medicare. The Hospital is paid for Medicare services based upon a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports.

Final determination of amounts earned is subject to review by the fiscal intermediary. Medicare reports have been settled through 2007. Management believes adequate provision has been made in the financial statements for any adjustments.

Management estimates an allowance for doubtful accounts receivable based on an evaluation of historical losses, current economic conditions, and other factors unique to the Hospital’s patient base.

Advertising

The Hospital expenses advertising costs as they are incurred. Advertising expenses for the years ended December 31, 2008 and 2007 were $191,586 and $228,804, respectively.

Inventories

Inventories consist mainly of medical, pharmaceutical and dietary supplies and are stated at the lower of cost, using the first-in, first-out (FIFO) method or market.

Assets Whose Use is Limited and Investments

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Assets whose use is limited are stated at fair value in the combined financial statements. These assets include investments designated by the Hospital Board for internal purposes and investments held by trustees for capital improvements and debt service. These investments consist primarily of cash and cash equivalents, certificates of deposit, mutual funds and U.S. Governmental securities and federally-backed mortgage obligations. Investment income, to the extent not capitalized, is reported as nonoperating income in the combined statements of revenues, expenses and changes in net assets.

The Hospital and Foundation hold Level 1 investments, in which fair market values are readily determinable using quoted prices in active markets for identical assets as determined by accounting principles generally accepted in the United States of America. Level 2 investments fair market values are determined by significant other observable inputs.

Capital Assets

Capital assets, which include land, land improvements, buildings and improvements, and equipment, are reported at historical cost. Contributed or donated assets are reported at estimated fair value at the time received. Capital assets under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods and estimated useful lives of capital assets reported in the financial statements are as follows:

Description	Capitalization Threshold		Depreciation Method	Range of Useful Lives
Land improvements	$	500	Straight line	2-25 years
Buildings and improvements	$	500	Straight line	5-40 years
Equipment	$	500	Straight line	2-20 years

For depreciated assets, the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

Compensated Absences

The Hospital's policies permit most employees to accumulate vacation and sick leave benefits 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. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. 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 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 current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are expendable noncapital net assets that must be used for a particular purpose, as specified by creditors or donors 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 invested in capital assets net of related debt or restricted net assets.

Grants and Contributions

From time to time, the reporting entity receives contributions from individuals and private organizations. Revenues from contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted for a specific operating purpose are reported as non-operating revenues. Amounts restricted for capital acquisitions are reported after non-operating revenues and expenses.

Restricted Resources

When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

Operating Revenues and Expenses

The reporting entity's combined statements of revenues, expenses and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Charity Care

The Hospital provides care without charges or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue.

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, restricted cash, investments, patient accounts receivable, assets whose use is limited, accounts payable, accrued liabilities, estimated third-party settlements, notes payable and long-term debt. The carrying amounts reported in the combined balance sheets for cash and cash equivalents, restricted cash, patient accounts receivable, accounts payable, accrued liabilities and estimated third-party settlements and physician loans and physician guarantees approximate fair value due to their nearness to maturity. The interest rate swap was a financial instrument, but it expired in February 2009.

The fair values of assets whose use is limited and investments are estimated based on quoted market prices for identical assets or other observable inputs. The fair value of long-term debt obligations is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements and it approximates the carrying value.

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

Accounting for Uncertainty in Income Taxes

The Hospital evaluates uncertain tax positions in accordance with accounting principles generally accepted in the United States of America and makes such accruals and disclosures as might be required there under.

Physician Receivables

The Hospital periodically will loan physicians money or guarantee certain incomes to physicians to attract physicians to the Hospital's market. The income guarantees generally provide for payments to the physicians for up to two years, with contractual provisions that the advances are forgiven if the physician continues to practice in the Hospital market for three years subsequent to the income guaranty period. The loans are generally due over a five-year period with varying interest rates.

The Hospital reports the income guarantees net of any forgiven amounts over the three-year forgiveness period. Loans and income guarantees that are not believed to be collectible or realized have been reserved to their estimated net realizable value.

The gross amount of the physician loans and guarantees is $2,016,190 with guarantees of $1,591,166. An allowance of $950,000 is recorded against physician receivables netting to a carrying value of $1,066,190.

Derivatives

The Hospital used derivatives to manage financial risks related to interest rate movements and the effects on its cash flows. The Hospital's derivative was an interest rate swap. The Hospital did not designate the interest rate swap agreement as a hedging instrument in accordance with accounting principles generally accepted in the United States of America. As a result, the agreement was recorded at its fair value with subsequent changes in fair value included in earnings in the accompanying statements of revenues, expenses and changes in net assets. The hedging instrument expired in February 2009.

The notional amount of the swap was $2,515,000 and $2,840,000 at December 31, 2008 and 2007 respectively.

Total Columns on Combined Statements

The total columns on the Combined Financial Statements for 2007 are captioned "Memorandum Only" to indicate that they are presented only to facilitate financial analysis in comparison to the current year.

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued which is October 14, 2009.

Reclassifications

Certain amounts from 2007 have been reclassified in order to conform to the current year presentation.

2. NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payers follows:

Medicare – On December 30, 2005, the Hospital elected the Medicare critical access hospital (CAH) designation, which changes the payment system for the care of Medicare beneficiaries. As a CAH, inpatient and outpatient services are paid on a cost reimbursement methodology. The Hospital is reimbursed for certain services at tentative rates with a final settlement determined after submission of annual cost reports by the Hospital and audit thereof by the Medicare fiscal intermediary.

Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates. In connection with the Indiana Medicaid program, the Hospital receives additional funding through the Hospital Care for the Indigent and the Medicaid Disproportionate Share programs. These payments are received by the Hospital on a periodic basis and the Hospital estimates the revenue associated with the payments and records the difference between estimated and actual amounts in the period known.

Revenue from the Medicare and Medicaid programs accounted for approximately 37 percent and 1 percent, respectively, of the Hospital's net patient revenue for the year ended 2008, and 45 percent and 4 percent, respectively, of the Hospital's net patient revenue for the year ended 2007. 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.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates. The following is a summary of net patient service revenue for the years ended December 31, 2008 and 2007:

	2008	2007
Inpatient service revenue	$ 20,775,736	$ 21,602,377
Outpatient service revenue	48,919,422	49,133,924
Gross patient service revenue	69,695,158	70,736,301
Contractual allowance	27,690,864	30,409,176
Charity care	1,053,593	538,003
Bad debts	4,538,755	3,407,315
Deductions from revenue	33,283,212	34,354,494
Net patient service revenue	$ 36,411,946	$ 36,381,807

3. CHARITY CARE

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of services and supplies furnished under its charity care policy. The charity care provided during 2008 and 2007 was $1,053,593 and $538,003, respectively.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

A new accounting pronouncement requires certain disclosures regarding the fair value of financial instruments. Financial instruments held by the Hospital impacted by this pronouncement include the Hospital's investments included in assets whose use is limited, which are measured using quoted prices in active markets and other significant other observable inputs.

The Hospital partially adopted the provisions of the pronouncement for 2008, but as is permitted will delay adoption of non-financial assets and non-financial liabilities covered by the pronouncement.

This pronouncement permits entities to partially defer the effective date for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, until 2009.

When fully adopted, the Hospital will apply the provisions the pronouncement to certain non-financial assets and liabilities and is currently evaluating the impact of the full adoption of this statement on the operations, changes in net assets and balance sheet. Using the provisions within the pronouncement, the Hospital has characterized its investments in securities, based on the priority of the inputs used to value the investments, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities [Level 1], and the lowest priority to unobservable inputs [Level 3]. If the inputs used to measure the investments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the investment.

Investments recorded in the consolidated balance sheet are categorized based on the inputs to valuation techniques as follows:

Level 1 – These are investments where values are based on unadjusted quoted prices for identical assets in an active market the Hospital has the ability to access. Investments are comprised of equities and mutual funds.

Level 2 – These are investments where values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the investments. These investments are comprised of certificates of deposit, government securities and corporate bonds.

Level 3 – These are investments where values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect assumptions of management about assumptions market participants would use in pricing the investments.

Fair values of financial instruments as of December 31, 2008 are as follows:

	Total	Quoted market prices for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3
Hospital				
Assets whose use is limited				
Certificates of deposit	$ 112,215	$ -0-	$ 112,215	$ -0-
Foundation				
Investments				
Money market	$ 3,112	$ 3,112	$ -0-	$ -0-
Mutual funds	188,178	188,178	-0-	-0-
Equities	129,347	129,347	-0-	-0-
Fixed Income Securities	13,522	13,522	-0-	-0-
	$ 334,159	$ 334,159	$ -0-	$ -0-

In addition to quoted market prices in active markets, valuation techniques included:

- Level 2-estimates on similar investments
- Level 3-management's estimate of the present value of future cash flows arising from the arrangement

5. DEPOSITS, INVESTMENTS AND INVESTMENT INCOME

Deposits with financial institutions in the State of Indiana at year-end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

Investments are carried at fair market value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Long-term investments consist of cash equivalents, certificates of deposit, mutual funds, U.S. Government securities and federally backed mortgage obligations.

The reporting entity's investments generally are reported at fair value, as discussed in Note 1. As of December 31, 2008 and 2007, the Hospital had the following investments and maturities, all of which were held in the Hospital's name by custodial banks that are agents of the Hospital.

December 31, 2008

		Investment Maturities (in Years)			
	Carrying amount	Less than 1	1 - 5	6 - 10	More than 10
Hospital					
Certificates of Deposit	$ 112,215	$ 112,215	$ -0-	$ -0-	$ -0-
Foundation					
Money market funds	$ 3,112	$ 3,112	$ -0-	$ -0-	$ -0-
Mutual funds	188,178	188,178	-0-	-0-	-0-
Equities	129,347	129,347	-0-	-0-	-0-
Fixed income securities	13,522	-0-	5,002	-0-	8,520
	$ 334,159	$ 320,637	$ 5,002	$ -0-	$ 8,520

December 31, 2007

		Investment Maturities (in Years)			
	Carrying amount	Less than 1	1 - 5	6 - 10	More than 10
Hospital					
Certificates of Deposit	$ 108,082	$ 108,082	$ -0-	$ -0-	$ -0-
Foundation					
Money market funds	$ 16,729	$ 16,729	$ -0-	$ -0-	$ -0-
Mutual funds	272,719	272,719	-0-	-0-	-0-
Equities	188,334	188,334	-0-	-0-	-0-
Fixed income securities	14,532	4,998	-0-	-0-	9,534
	$ 492,314	$ 482,780	$ -0-	$ -0-	$ 9,534

Interest rate risk - The Hospital does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Credit risk - Statutes authorize the Hospital to invest in interest bearing deposit accounts, passbook savings accounts, certificates of deposit, money market accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Concentration of credit risk - The Hospital places no limit on the amount it may invest in any one issuer. The Hospital maintains its investments, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on investments.

Deposits and investments consisted of the following as of December 31, 2008 and 2007:

	2008	2007
Hospital		
Carrying amount		
Deposits	$ 5,260,468	$ 3,104,791
Investments	112,215	108,082
	$ 5,372,683	$ 3,212,873
Included in the following balance sheet captions		
Cash and cash equivalents	$ 1,560,468	$ 3,104,791
Restricted cash	3,700,000	-0-
Board designated funds	112,215	108,082
	$ 5,372,683	$ 3,212,873
Foundation		
Carrying amount		
Deposits	$ 10,483	$ 15,580
Investments	334,159	492,314
	$ 344,642	$ 507,894
Included in the following balance sheet captions		
Cash and cash equivalents	$ 10,483	$ 15,580
Investments	334,159	492,314
	$ 344,642	$ 507,894

6. ACCOUNTS RECEIVABLE AND PAYABLE

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at December 31, 2008 and 2007, consisted of the following amounts:

	2008	2007
Patient accounts receivable		
Hospital		
Receivable from patients and their insurance carriers	$ 9,556,760	$ 11,238,290
Receivable from Medicare	2,358,106	3,614,510
Receivable from Medicaid	1,165,394	2,006,552
Total patient accounts receivable	13,080,260	16,859,352
Less allowance for contractual agreements and uncollectible amounts	7,728,543	9,745,436
Patient accounts receivable, net	$ 5,351,717	$ 7,113,916
Accounts payable and accrued expenses		
Hospital		
Payable to suppliers and other	$ 3,877,498	$ 3,583,701
Payable to employees (including payroll taxes and benefits)	1,470,654	1,400,355
Other payables	327,240	451,863
Total accounts payable and accrued expenses	$ 5,675,392	$ 5,435,919
Foundation		
Payable to suppliers	$ 6,196	$ 11,257

7. CAPITAL ASSETS

A summary of capital assets at December 31, 2008 and 2007 is as follows:

	Balance December 31, 2007	Additions	Retirements & Transfers	Balance December 31, 2008
Hospital				
Land	$ 750,982	$ -0-	$ (4,494)	$ 746,488
Land improvements	825,755	2,737	-0-	828,492
Buildings and improvements	26,293,486	198,350	632,216	27,124,052
Equipment	29,225,040	399,290	-0-	29,624,330
Construction in progress	402,687	801,560	(632,216)	572,031
Total capital assets	57,497,950	1,401,937	(4,494)	58,895,393
Less accumulated depreciation				
Land improvements	637,201	22,930	-0-	660,131
Buildings and improvements	12,964,022	775,837	-0-	13,739,859
Equipment	24,485,731	1,419,910	-0-	25,905,641
Total accumulated depreciation	38,086,954	2,218,677	-0-	40,305,631
Hospital capital assets, net	$ 19,410,996	$ (816,740)	$ (4,494)	$ 18,589,762

	Balance December 31, 2006	Additions	Retirements & Transfers	Balance December 31, 2007
Hospital				
Land	$ 750,982	$ -0-	$ -0-	$ 750,982
Land improvements	817,853	7,902	-0-	825,755
Buildings and improvements	26,153,375	34,111	106,000	26,293,486
Equipment	28,641,409	583,631	-0-	29,225,040
Construction in progress	315,798	192,889	(106,000)	402,687
Total capital assets	56,679,417	818,533	-0-	57,497,950
Less accumulated depreciation				
Land improvements	613,042	24,159	-0-	637,201
Buildings and improvements	12,172,453	791,569	-0-	12,964,022
Equipment	22,529,397	1,956,334	-0-	24,485,731
Total accumulated depreciation	35,314,892	2,772,062	-0-	38,086,954
Hospital capital assets, net	$ 21,364,525	$ (1,953,529)	$ -0-	$ 19,410,996

8. NOTES PAYABLE

The Hospital periodically borrows funds from banks to finance certain operating expenses. The note payable bears interest at 7.50% is unsecured and matured October 1, 2009.

The Hospital also held a short-term loan with a bank related to a forbearance agreement during 2008, which was subsequently refinanced to long-term debt. See Note 9 for further details related to the re-financing.

The following is a summary of the short-term note payable to bank activity for the years ended December 31, 2008 and 2007:

	Balance December 31, 2007	Additional Borrowings	Payments	Subsequent Refinancing	Balance December 31, 2008
Notes payable	$ 498,699	$ 7,630,000	$ 434,891	$ (7,020,000)	$ 673,808

	Balance December 31, 2006	Additional Borrowings	Payments	Subsequent Refinancing	Balance December 31, 2007
Notes payable	$ 120,479	$ 578,220	$ 200,000	$ -0-	$ 498,699

9. LONG-TERM OBLIGATIONS

The following is a summary of long-term obligation transactions for the Hospital for the years ended December 31, 2008 and 2007:

	Balance December 31, 2007	Additional Borrowings	Payments	Subsequent Refinancing	Balance December 31, 2008	Current Portion	Total Long-Term Debt
Revenue bonds payable	$ 7,205,000	$ -0-	$ 7,205,000	$ 7,020,000	$ 7,020,000	$ -0-	$ 7,020,000
Capital lease obligations	1,066,391	75,000	441,526	-0-	699,865	281,228	418,637
	$ 8,271,391	$ 75,000	$ 7,646,526	$ 7,020,000	$ 7,719,865	$ 281,228	$ 7,438,637

	Balance December 31, 2006	Additional Borrowings	Payments	Subsequent Refinancing	Balance December 31, 2007	Current Portion	Total Long-Term Debt
Revenue bonds payable	$ 7,515,000	$ -0-	$ 310,000	$ -0-	$ 7,205,000	7,205,000	$ -0-
Capital lease obligations	1,136,286	287,973	357,868	-0-	1,066,391	391,528	674,863
	$ 8,651,286	$ 287,973	$ 667,868	$ -0-	$ 8,271,391	$ 7,596,528	$ 674,863

2003 Revenue Bonds Payable

The bonds payable consisted of health facility bonds in an original amount of $8,365,000 dated November 18, 2003. Interest was due monthly at a defined weekly variable rate and the bond payments were made annually on November 1. The Hospital had entered into an interest rate swap, which is more fully described in Note 10. The bonds were secured by an irrevocable letter of credit dated November 19, 2003, which expired in 2008. The bond was called when the letter of credit expired and the bond was paid in full with a draw on the letter of credit in the approximate amount of $7,200,000.

Forbearance Agreement

A Forbearance Agreement was signed by the Hospital and a bank in December 2008. The agreement expired May 31, 2009.

The related Reimbursement Obligation was secured by substantially all of the assets of the Hospital. Interest was paid monthly at a rate of prime plus 5%.

The bank required $3.7 Million to be held in restricted funds to pay the fees and payments required by the agreement during the entire Forbearance Period. The restricted funds were used to pay legal fees, one payment of the reimbursement obligation and accrued interest. The Hospital violated specific conditions on their forbearance agreement with the Bank and the full $3.7 Million was withdrawn and used to pay the above amounts with the remaining portion paid directly on the reimbursement obligation subsequent to year-end.

2009 Revenue Bonds Payable

The Hospital subsequently obtained long-term financing as is described herein. The Indiana Bond Bank (the “Bond Bank”) issued tax-exempt Special Program Bonds, Series 2009B-1(Dunn Memorial Hospital Project) in the amount of $4,040,000 and Taxable Special Program Bonds, Series 2009B-2 (Dunn Memorial Hospital Project) in the amount of $2,980,000 in 2009 pursuant to the provisions of a Trust Indenture with the Trustee, UMB Bank, N.A. Indianapolis, Indiana in the aggregate principal amount of $7,020,000. The Series 2009B-1 and the Series 2009B-2 Bonds shall be referred to collectively as the Series 2009 Bonds.

The Bond Bank is the obligor to the bondholders. The bonds are insured. The Series 2009 Bonds are issued by the Bond Bank for the principle purposes of (a) providing funds for the purchase of certain Series 2009 Qualified Obligations of the Qualified Entity (The Lawrence County Hospital Association), (b) funding the Reserve Requirement of the Debt Service Reserve Funds and (c) paying costs related to the issuance of the Series 2009 Bonds. The Series 2009 Bonds have interest rates ranging from 1.5% to 6.375% to be paid annually through February 1, 2029. Certain Series 2009 Bonds are subject to extraordinary mandatory redemption prior to maturity including upon the sale of all or substantially all of the Premises as defined.

The Lawrence County Hospital Association (the “Association”) was created under the Indiana Code and is authorized to enter into leases with a county in order to provide funds to finance, acquire, renovate, equip and lease land and buildings. As the Qualified Entity, the Association issued Lease Rental Revenue Bonds, Series 2009B and Taxable Lease Rental Revenue Bonds, Series 2009C. The Series 2009B Qualifed Obligations and the Series 2009C Qualified Obligations, collectively referred to as the Series 2009 Qualified Obligations were issued pursuant to a Trust Indenture in 2009 between the Association and the Trustee.

The Series 2009 Qualified Obligations are payable from lease rental revenues received by the Qualified Entity as lessor, from Lawrence County, Indiana, acting through its Board of Commissioners and the Board of Trustees of Dunn Memorial Hospital as lessees (collectively, the “Lessee”) under a lease agreement entered into in 2009 for certain Hospital additions and improvements (the “Leased Premises”).

Pursuant to the Lease, the Lessee has agreed to make payments directly to the Trustee in such amounts and at such times as are sufficient to pay in full, when due, the principal and interest of the Series 2009 Qualified Obligations. The County and the Hospital anticipate that the full lease rental payments will be paid from Hospital revenues. The lease rental revenues are pledged to secure the Series 2009 Qualified Obligations. In addition to the Lease, the Series 2009 Qualified Obligations are secured by certain property taxes that could be appropriated and/or levied by the County as is defined in the agreement.

The Series 2009 Qualified Obligations and the Lease have essentially the same terms with interest rates ranging from 1.5% to 6.375% with interest plus a fixed amount of principle as determined in the agreements, to be paid semi-annually on January 15 and July 15 with final maturity on January 15, 2029. The net proceeds on the Series 2009 Qualified Obligations among other purposes were used to refinance certain debt obligations including the conduit financing that replaced the 2003 Revenue Bonds, to fund the required debt service reserve funds, and to re-finance other existing obligations. The Trust Indenture has certain compliance requirements for which the Hospital believes it is in compliance.

Maturities of long-term debt for the years succeeding December 31, 2008 for the Revenue Bonds issued in 2009 are as follows:

Year Ending December 31,	
2009	$ -0-
2010	270,000
2011	245,000
2012	260,000
2013	260,000
Thereafter	5,985,000
	$ 7,020,000

Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. The capital lease obligations have varying imputed interest rates of 2.1% to 10%, expiring through November 2012. Capital leases are collateralized by leased equipment with a cost of approximately $1.7 million and $1.6 million at December 31, 2008 and 2007, respectively. Accumulated depreciation on capital leases was approximately $814,000, and $494,000 at December 31, 2008 and 2007, respectively.

Scheduled principal and interest repayments on capital lease obligations are as follows:

Year Ending	Capital Lease Obligations	
December 31,	Principal	Interest
2009	$ 281,228	$ 32,849
2010	219,143	18,664
2011	140,253	6,114
2012	59,241	1,738
	$ 699,865	$ 59,365

10. INTEREST RATE SWAP AGREEMENT

The Hospital's asset/liability strategy was to have a mixture of fixed and variable-rate debt to take advantage of market fluctuations. As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations and to lower its borrowing costs when compared against fixed-rate debt at the time of issuance, the Hospital entered into a "cash flow hedge interest rate swap" agreement for its long-term note payable to bank. The intention of the swap was to effectively change the Hospital's variable interest rate on this note to a synthetic fixed rate of 2.893%.

Under the interest rate swap, the Hospital received interest from the counterparty at the BMA rate and paid to the counterparty at a fixed rate of 2.893% on the notional amounts. The Hospital paid or received the net interest amount monthly with the monthly settlements included in interest expense. The interest rate swap could be terminated by the Hospital upon 30 days written notice to the counterparty. The Hospital recorded the changes in fair value of the interest rate swap in nonoperating expenses. The fair value of the interest rate swap approximated (7,744) and ($991) at December 31, 2008 and 2007, respectively.

The agreement was entered into on February 11, 2004, and expired February 1, 2009.

The total interest rate swap unrealized loss recognized on the financial statements was (3,435) and ($34,284) for the years ended December 31, 2008 and 2007, respectively.

11. PENSION PLAN

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. Employer contributions to the plan were $697,028 and $471,569 for 2008 and 2007, respectively.

12. COMMITMENTS AND CONTINGENCIES

Operating leases - lessee

The Hospital is committed under a non-cancelable operating lease for equipment. The lease expires June 30, 2009. Total rent expense for 2008 and 2007 was $285,501 and $302,346, respectively.

The following is a schedule of future minimum lease payments under operating leases as of December 31, 2008, that have initial or remaining lease terms in excess of one year:

Year ending December 31,	
2009	$ 46,607

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may result in litigation. Some of these allegations are in areas not covered by the Hospital's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegation regarding employment practices or performance of contracts. The Hospital 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. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

13. CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors for 2008 and 2007 was as follows:

	2008	2007
Medicaid	10%	13%
Medicare	20%	24%
Blue Cross	13%	10%
Self pay	41%	37%
Other	16%	16%
	100%	100%

14. EMPLOYEE HEALTH PLAN

During 2006, the Hospital began participation in a self-funded health plan covering substantially all employees. Covered services include medical benefits. The plan has annual reinsurance coverage for individual claims in excess of $60,000 per year with an aggregate maximum of approximately $1,000,000. Employee health insurance benefit expense was $1,772,177 and $1,771,233 for 2008 and 2007, respectively.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

Changes in the balance of claim liabilities during the past two years are as follows:

	2008	2007
Unpaid claims (refunds), beginning of year	$ 400,000	$ (161,766)
Incurred claims and changes in estimates	1,772,177	1,771,233
Claim payments	(1,872,177)	(1,209,467)
Unpaid claims, end of year	$ 300,000	$ 400,000

15. MALPRACTICE COVERAGE

The State of Indiana puts a judgment cap of $1,250,000 on malpractice claims for those institutions and individual physicians willing to participate in the state funded insurance "pool". The "pool" requires that an institution/physician be responsible for the first $250,000 of every claim and the state will fund the remaining balance of each claim. In addition to the above, the state also requires that each individual physician carry a policy year aggregate limit of $750,000 and the institution (based upon size) carry a $5,000,000 policy year aggregate limit.

The Hospital has eliminated its risk by purchasing an insurance policy that covers all claims for the required $250,000 occurrence limit and the $5,000,000 statutory aggregate limit for the institution and a $250,000 occurrence and $750,000 statutory aggregate limit for each scheduled physician. In addition to the above limits, the insurance policy also provides an umbrella professional liability limit of $1,000,000 that pays any claim over the initial $250,000 for any instances in which the state funded insurance pool does not cover the claim.

16. DISCONTINUED OPERATIONS

During 2008, the Hospital discontinued its behavioral health unit. Operating results are included in the loss from operations of the discontinued components in the statement of revenues, expenses and changes in net assets of $114,552 and $26,602 for 2008 and 2007, respectively. Net patient service revenues for the discontinued components were $497,508 and $1,044,623 for 2008 and 2007, respectively.

17. SUBSEQUENT EVENTS

Subsequent to December 31, 2008, the Hospital refinanced certain long-term debt. See Note 9 for the details.

18. MANAGEMENT'S PLANS

The Hospital experienced operating losses during the years ended December 31, 2008 and 2007, as well as diminishing cash reserves. During 2009, management has reduced operating expenses and experienced positive cash flows through August 2009.

The Hospital elected to convert to a Critical Access Hospital on December 30, 2005, to take advantage of enhanced reimbursement from the Medicare Program. Management and continues to explore additional options for enhancing reimbursement from both the Medicare and Medicaid Programs and ensure that payments due from these Programs are realized. Additionally, several managed care contracts were negotiated during the first half of 2007 that provided additional net patient service revenue. The Hospital has managed to reduce operating expenses and continues to take actions to reduce wages and benefits to a competitive level as compared to other similar health systems.

The Hospital obtained long-term financing that replaced current obligations in August 2009 at favorable rates in an effort to improve liquidity. These revenue bonds are backed by the County.