

HANCOCK REGIONAL HOSPITAL

COMBINED FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

CPAs / ADVISORS



HANCOCK REGIONAL HOSPITAL

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Hancock Regional Hospital
Greenfield, Indiana

We have audited the accompanying combined balance sheets of Hancock Regional Hospital (the Hospital) and component units as of December 31, 2008 and 2007, and the related combined statements of operations and changes in net assets and cash flows for the years 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.

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 audits 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 2007, and the results of its combined 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.

Management's discussion and analysis on pages i through vii is not a required part of the basic combined financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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

April 23, 2009

REQUIRED SUPPLEMENTARY INFORMATION

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2008 AND 2007

Our discussion and analysis of Hancock Regional Hospital's financial performance provides an overview of the Hospital's financial activities for the fiscal years ended December 31, 2008 and 2007. Please read it in conjunction with the Hospital's financial statements, which begin on page 2. Unless otherwise indicated, amounts are in thousands.

FINANCIAL HIGHLIGHTS

- The Hospital reported a change in net assets of \$(849) and \$7,141 in 2008 and 2007 respectively.
- Nonoperating income (expense) was \$(8,723) and \$875 in 2008 and 2007, respectively.

USING THIS ANNUAL REPORT

The Hospital's 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 of the Hospital, including resources held by the Hospital but restricted for specific purposes by contributors, grantors, or enabling legislation.

THE BALANCE SHEET AND STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS

Our analysis of the Hospital finances begins on page ii. One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. You can think of the Hospital's net assets—the difference between assets and liabilities—as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Hospital.

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2008 AND 2007

THE STATEMENT OF CASH FLOWS

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?"

THE HOSPITAL'S NET ASSETS

The Hospital's net assets are the difference between its assets and liabilities reported in the Balance Sheet on page 2. The Hospital's net assets increased in 2007 by \$7,141 (10.26%) and decreased in 2008 by \$(849) (-1.11 percent) as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Assets

	2008	2007	2008 - 2007	
			\$ Change	% Change
Assets				
Current Assets	\$ 22,459	\$ 27,283	\$ (4,824)	-17.68%
Capital Assets, Net	62,175	65,194	(3,019)	-4.63%
Restricted and Limited Use Assets	29,274	32,632	(3,358)	-10.29%
Other Noncurrent Assets	6,124	6,123	1	0.02%
Total Assets	<u>120,032</u>	<u>131,232</u>	<u>(11,200)</u>	<u>-8.53%</u>
Liabilities				
Long - Term Debt Outstanding	32,005	45,475	(13,470)	-29.62%
Other Current and Non Current Liabilities	12,134	9,015	3,119	34.60%
Total Liabilities	<u>44,139</u>	<u>54,490</u>	<u>(10,351)</u>	<u>-19.00%</u>
Net Assets				
Unrestricted	43,775	51,666	(7,891)	-15.27%
Invested in Capital Assets, Net of related Debt	27,324	17,790	9,534	53.59%
Restricted by Trustee for Debt Service	4,241	6,619	(2,378)	-35.93%
Donor Restricted	553	667	(114)	-17.09%
Total Net Assets	<u>\$ 75,893</u>	<u>\$ 76,742</u>	<u>\$ (849)</u>	<u>-1.11%</u>

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2008 AND 2007

A significant component of the change in the Hospital's assets is the decrease in capital assets net of depreciation. Capital Assets net of Depreciation decreased (4.63)% or \$(3,019) from 2007 to 2008. Significant capital purchases in 2008 included the purchase of 2 new CT Scanners to serve the diagnostic imaging needs of the community. Some of the other capital purchases included renovations to the Hospital Geriatric Psych Unit and renovations and new Total Joint and Spine Program area. Another significant component of change in the Hospital's assets are the decreases in Current Assets and Restricted and Limited Use Assets. The change is due to retirement of Long – Term Debt prior to maturity.

OPERATING RESULTS AND CHANGES IN THE HOSPITAL'S NET ASSETS

In 2008, the Hospital's net assets decreased by \$(849) or (1.11%) percent, as shown in Table 2. This decrease is made up of very different components.

Table 2: Operating Results and Changes in Net Assets

	2008 - 2007			
	2008	2007	\$ Change	% Change
Operating Revenue				
Net patient service revenue	\$ 89,755	\$ 79,135	\$ 10,620	13.42%
Other	8,990	5,733	3,257	56.81%
Total operating revenue	<u>98,745</u>	<u>84,868</u>	<u>13,877</u>	<u>16.35%</u>
Operating expenses				
Salaries and benefits	44,751	42,430	2,321	5.47%
Medical supplies and drugs	12,411	11,690	721	6.17%
Purchased services and medical fees	21,251	12,548	8,703	69.36%
Depreciation and amortization	8,202	8,223	(21)	-0.26%
Other operating expense	4,256	3,711	545	14.69%
Total operating expense	<u>90,871</u>	<u>78,602</u>	<u>12,269</u>	<u>15.61%</u>
Operating income	<u>7,874</u>	<u>6,266</u>	<u>1,608</u>	<u>25.66%</u>
Nonoperating income				
Noncapital contributions	849	336	513	152.68%
Other nonoperating income	(504)	(280)	(224)	80.00%
Interest expense	(2,843)	(2,491)	(352)	14.13%
Investment income	(6,225)	3,310	(9,535)	-288.07%
Total Nonoperating income	<u>(8,723)</u>	<u>875</u>	<u>(9,598)</u>	<u>-1096.91%</u>
Change in net assets	(849)	7,141	(7,990)	-111.89%
Net assets				
Beginning of year	76,742	69,601	7,141	10.26%
End of year	<u>\$ 75,893</u>	<u>\$ 76,742</u>	<u>\$ (849)</u>	<u>-1.11%</u>

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2008 AND 2007

SOURCES OF REVENUE

During 2008 the Hospital derived substantially all of its revenue from patient service and other related activities. Revenue includes, among other items, revenue from the Medicare and Medicaid programs, patients, insurance carriers, preferred provider organizations, and managed care programs.

The table below presents the percentages of Gross revenue for patient services by payer, for the years ended December 31, 2008 and 2007, respectively.

PAYOR MIX

	<u>2008</u>	<u>2007</u>
Medicare	46.38%	45.93%
Medicaid	7.50%	8.33%
Commercial	36.75%	36.58%
Self-Pay	6.98%	6.46%
Other	2.39%	2.70%
	<u>100%</u>	<u>100%</u>

The Hospital provides care to patients under payment arrangement with Medicare, Medicaid, and various managed care programs. Services provided under those arrangements are paid at predetermined rates and/or reimbursable costs as defined. Provisions have been made in the financial statements for contractual adjustments, which represent the difference between the standard charges for services and the actual or estimated payment. It was noted that the payor mix in 2008 shifted from Medicaid to Medicare and Self Pay with a slight increase in Commercial insurance payor. The Hospital also received a Disproportionate Share Hospital Payment for years 2006, 2007 and estimated for 2008. This payment totaled \$5,891.

OPERATING GAINS

The first component of the overall change in the Hospital's net assets is its operating income gain, generally the difference between net patient service and the expenses incurred to perform those services. In each of the past two years, the Hospital has reported an operating gain. This is consistent with the Hospital's entire operating history. The Hospital's operations were begun in 1951 as a county owned and operated hospital under Indiana Code 16-22. Operating Gains in 2008 increased by \$1,608 or 25.66% from 2007.

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2008 AND 2007

The increase in the Hospital's total operating revenues in 2008 of \$1,608 or 25.66% from 2007 is the result of a rate increase and real growth in key areas. During 2008, the Hospital increased gross charge rates 8% compared to 2007. More importantly, the Hospital experienced statistical changes in the following areas:

Statistical Growth	2008	2007	2008-2007 % Increase / <Decrease>
Patient Days	20,326	20,942	-2.94%
Diagnostic Imaging	67,137	58,549	14.67%
Lab	345,270	377,945	-8.65%
Pharmacy	1,291,589	1,532,037	-15.69%
Rehab Services	83,444	84,935	-1.76%
Home Health Services	44,118	41,582	6.10%
Outpatient Clinic Services	16,459	13,454	22.34%

Excluded from net patient service revenue are charges for patient service waived under the Hospital's charity care policy. Charity care represents unreimbursed charges incurred by the Hospital in providing uncompensated care to indigent patients. Based on established rates, gross charges of \$4,949 were waived during 2008. This is an increase of \$2,625 from the previous year. Management's commitment to provide emergency care for all patients without regard to their ability to pay contributed to this increase.

The Hospital sometimes provides care for patients who have little or no health insurance or other means of repayment. As discussed, this service to the community is consistent with the goals established for the Hospital when it was established in 1951. Because there is no expectation of repayment, charity care is not reported as patient service revenues of the Hospital.

NON-OPERATING REVENUES AND EXPENSES

Non operating revenues are the result of changes in the Hospital's Investment Income and other Non Capital Grants and Contributions. The Hospital's Investment Income decreased due to unfavorable changes in market values during 2008. The Hospital's 2008 nonoperating (expense) decreased \$(9,598) from 2007 nonoperating income. Unfavorable market conditions significantly influenced this change.

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2008 AND 2007

GRANTS, CONTRIBUTIONS, AND ENDOWMENTS

The Hospital receives both capital and operating grants from various state and federal agencies for specific programs. Capital and operating grants received in 2008 totaled \$554 compared to \$270 in 2007. Some of the significant grants received by the Hospital are:

- Tobacco Cessation – From Indiana State Department of Health for prevention of tobacco use
- Rural Health Clinic – Knightstown from Indiana State Department of Health – for rural health clinic operations in Knightstown
- Disaster Preparedness & Bioterrorism– From the State Department of Health – for Hospital disaster preparation and bioterrorism.
- Lifeline patient monitoring - Central Indiana Power – for remote monitoring of home-bound elderly patients
- Education Department – Substance Abuse Prevention
- Critical Needs Expansion
- Women’s Health Center

THE HOSPITAL’S CASH FLOWS

Changes in the Hospital’s cash flows are consistent with changes in operating losses and non-operating revenues and expenses, discussed earlier.

CAPITAL ASSETS AND DEBT ADMINISTRATION

CAPITAL ASSETS

At the end of 2008, the Hospital had \$62.2 million invested in capital assets, net of accumulated depreciation, as detailed in Note 8 to the financial statements.

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2008 AND 2007

DEBT

At year-end, the Hospital had \$32.8 million in revenue notes, mortgage loans, and capital lease obligations outstanding. The Indiana Bond Bank issued new debt in June 2004 totaling \$35 million pursuant to a Trust Indenture with the Trustee – the Bank of New York Trust Company. The Hancock County Association was created in 2004 under Indiana Code and is authorized to enter into leases with a county to provide funds to the Hospital. The Association issued the Series 2004 C Qualified Obligations pursuant to a Trust Indenture dated June 1 2004 between the Association and Trustee. This debt was issued for a new 122,000 square foot hospital expansion with the expanded services in Emergency Medicine, Cardiology and Critical Care and an expansion of space for future health needs of the community. The Board of Trustees of the Hospital and Hancock County, Indiana, acting through its Board of Commissioners are lessees with the Association for the Hospital additions and improvements. The Lessee has agreed to make payments directly to the Trustee in amounts and times sufficient to pay in full, when due, the principal and interest of the Series 2004 C Obligations. The County and Hospital anticipate that the full lease rental payments will be paid from Hospital Revenues. This debt consists of Revenue Bonds maturing in January 2031. This transaction is further detailed in Note 9.

During 2008, the Hospital extinguished bond debt of \$12,205. Total debt has been decreased \$14,441 from the previous year.

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 Chief Financial Officer's Office, 801 N State Street, Greenfield, IN 46140.

HANCOCK REGIONAL HOSPITAL

COMBINED BALANCE SHEETS DECEMBER 31, 2008 AND 2007

	2008	2007
ASSETS		
Current assets		
Cash and cash equivalents	\$ 9,919,301	\$ 7,294,162
Investments	1,505,940	4,658,061
Patient accounts receivable, less allowance for uncollectible accounts of \$9,672,368 in 2008 and \$11,971,041 in 2007	8,085,983	11,279,627
Other receivables	498,380	379,051
Inventories	1,739,963	1,187,752
Prepaid expenses	709,103	634,319
Current portion of assets whose use is limited	-0-	1,850,000
Total current assets	<u>22,458,670</u>	<u>27,282,972</u>
Assets whose use is limited		
Board designated funds	24,479,910	27,195,277
Trustee held funds, less current portion	4,240,828	4,769,141
Donor restricted funds	553,275	667,652
Total assets whose use is limited	<u>29,274,013</u>	<u>32,632,070</u>
Capital assets		
Land and land improvements	5,487,028	4,744,146
Buildings and fixed equipment	93,194,212	84,978,604
Major movable equipment	40,372,044	39,161,815
Construction in progress	543,758	7,543,450
Total capital assets	<u>139,597,042</u>	<u>136,428,015</u>
Less accumulated depreciation	77,421,700	71,234,310
Capital assets, net	<u>62,175,342</u>	<u>65,193,705</u>
Other assets		
Bond issuance costs, net of accumulated amortization of \$364,247 in 2008 and \$204,264 in 2007	118,003	278,181
Other assets	6,006,569	5,845,163
Total other assets	<u>6,124,572</u>	<u>6,123,344</u>
Total assets	<u>\$ 120,032,597</u>	<u>\$ 131,232,091</u>

See accompanying notes to financial statements.

HANCOCK REGIONAL HOSPITAL

COMBINED BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

LIABILITIES AND NET ASSETS

	<u>2008</u>	<u>2007</u>
Current liabilities		
Current portion of long-term debt	\$ 850,000	\$ 1,821,965
Accounts payable and other liabilities	5,853,814	2,740,028
Accrued salaries and related liabilities	4,567,421	3,509,998
Estimated third-party settlements	863,116	942,669
Total current liabilities	<u>12,134,351</u>	<u>9,014,660</u>
Long-term debt, less current portion	<u>32,005,000</u>	<u>45,474,787</u>
Total liabilities	44,139,351	54,489,447
Net assets		
Unrestricted	41,778,801	51,558,898
Invested in capital assets, net of related debt	29,320,342	17,896,953
Restricted by trustee for debt service	4,240,828	6,619,141
Donor restricted-expendable	553,275	667,652
Total net assets	<u>75,893,246</u>	<u>76,742,644</u>
Total liabilities and net assets	<u>\$ 120,032,597</u>	<u>\$ 131,232,091</u>

See accompanying notes to financial statements.

HANCOCK REGIONAL HOSPITAL

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

	2008	2007
Operating revenue		
Net patient service revenue	\$ 89,755,482	\$ 79,135,145
Other operating revenue	8,989,970	5,733,248
Total operating revenue	98,745,452	84,868,393
Operating expenses		
Salaries and wages	35,426,664	33,330,540
Employee benefits	9,324,683	9,099,504
Professional medical fees	1,028,011	1,039,434
Supplies and drugs	12,411,069	11,689,765
Purchased services	20,223,418	11,508,260
Utilities and insurance	3,082,579	2,588,300
Depreciation and amortization	8,201,934	8,222,710
Other	1,172,939	1,123,498
Total operating expenses	90,871,297	78,602,011
Operating income	7,874,155	6,266,382
Nonoperating income (expense)		
Noncapital contributions	849,015	335,827
Other nonoperating income (expense)	(503,929)	(280,142)
Interest expense	(2,843,239)	(2,490,710)
Investment income	(6,225,400)	3,310,160
Total nonoperating income (expense)	(8,723,553)	875,135
Change in net assets	(849,398)	7,141,517
Net assets		
Beginning of year	76,742,644	69,601,127
End of year	\$ 75,893,246	\$ 76,742,644

See accompanying notes to financial statements.

HANCOCK REGIONAL HOSPITAL

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

	2008	2007
Operating activities		
Cash received from patients and third party payors	\$ 92,869,573	\$ 77,539,899
Cash paid to employees for wages and benefits	(43,693,924)	(41,838,906)
Cash paid to vendors for goods and services	(35,550,554)	(29,720,764)
Other operating receipts, net	8,989,970	5,733,248
Net cash from operating activities	22,615,065	11,713,477
Noncapital financing activities		
Noncapital contributions	849,015	335,827
Other nonoperating	(503,929)	(280,142)
Net cash from noncapital financing activities	345,086	55,685
Capital and related financing activities		
Acquisition and construction of capital assets	(5,111,352)	(9,165,664)
Interest expense on long-term debt	(2,843,239)	(2,490,710)
Principal payments on long-term debt, net	(14,441,752)	(1,721,162)
Net cash from capital and related financing activities	(22,396,343)	(13,377,536)
Investing activities		
Other assets and liabilities	(161,406)	(2,495,161)
Investment income	(6,225,400)	3,310,160
Other change in assets whose use is limited, net	4,281,488	(4,521,252)
Net cash from investing activities	(2,105,318)	(3,706,253)
Net change in cash and cash equivalents	(1,541,510)	(5,314,627)
Cash and cash equivalents		
Beginning of year	13,666,110	18,980,737
End of year	\$ 12,124,600	\$ 13,666,110

See accompanying notes to financial statements.

HANCOCK REGIONAL HOSPITAL

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

	2008	2007
Reconciliation of operating income to net cash from operating activities		
Operating income	\$ 7,874,155	\$ 6,266,382
Adjustment to reconcile operating income to net cash from operating activities		
Depreciation and amortization	8,201,934	8,222,710
Bad debts	7,368,141	6,705,779
Changes in assets and liabilities		
Patient accounts receivable	(4,174,497)	(8,427,222)
Other current assets	(746,324)	(852,823)
Accounts payable and other liabilities	3,113,786	(918,684)
Accrued salaries and related liabilities	1,057,423	591,138
Estimated third-party settlements	(79,553)	126,197
Net cash from operating activities	<u>\$ 22,615,065</u>	<u>\$ 11,713,477</u>
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents:		
In current assets	\$ 9,919,301	\$ 7,294,162
In investments	-0-	3,109,288
In assets whose use is limited	2,205,299	3,262,660
Total cash and cash equivalents	<u>\$ 12,124,600</u>	<u>\$ 13,666,110</u>

See accompanying notes to financial statements.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

1. SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Hancock Regional Hospital (the Hospital) is an acute-care hospital located in Greenfield, Indiana, organized for the purpose of providing healthcare services to the residents of Hancock County and the surrounding communities. Hancock Regional Hospital is a county owned facility operated under the Indiana County Hospital Law, Indiana Code 16-22. The Board of County Commissioners of Hancock County appoints the Governing Board of the Hospital and a financial benefit/burden relationship exists between the County and the Hospital. For these reasons, the Hospital is considered a component unit of Hancock County.

Accounting principles generally accepted in the United States of America require that these combined financial statements present the Hospital and its blended component units, collectively referred to as the "primary government." The component units discussed below are included in the Hospital's reporting entity because of the significance of their operation or financial relationship with the Hospital. A blended component unit although a legally separate entity is in substance part of the primary government unit's operations and exists solely or primarily to provide services to or for the Hospital.

Blended Component Units

The accompanying combined financial statements include the accounts of Hancock Memorial Hospital Foundation, Inc. (the 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 for financial reporting purposes. The accompanying combined financial statements also include the accounts of the Wellness Center, LLC, a separate for-profit entity organized to support the operations of the Hospital. These separate financial statements may be obtained through contacting management of 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Proprietary Fund Accounting

The Hospital utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis of accounting. Substantially all revenues and expenses are subject to accrual.

Accounting for Uncertainty in Income Taxes

The Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), which clarifies generally acceptable accounting principles for recognition, measurement, presentation and disclosure relating to uncertain tax positions. FIN 48 applies to business enterprises, not-for-profit entities, and pass-through entities, such as S corporations and limited liability companies. As permitted by FIN 48 (as amended), the Hospital elected to defer the application of FIN 48 until issuance of its December 31, 2009 financial statements. For financial statements covering periods prior to calendar 2009, the Hospital evaluates uncertain tax positions in accordance with existing generally accepted accounting principles and makes such accruals and disclosures as might be required there under.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement Number 20, *Accounting and Financial Reporting For Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, 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.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid assets with maturity dates of 90 days or less when purchased with the exception of those included with Assets Whose Use is Limited. 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.

Patient Accounts Receivable and Net Patient Service Revenue

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. 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 customer base.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

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

A summary of the payment arrangements with major third-party payors follows.

The Hospital is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The Hospital is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG). The Hospital is reimbursed for Medicare and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue.

Revenue from the Medicare and Medicaid programs accounted for approximately 37 percent and 7 percent, respectively, of the Hospital's net patient revenue for the year ended 2008, and 32 percent and 8 percent, respectively, of the Hospital's net patient revenue, for the year ended 2007. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Hospital recognized revenue related to the Medicaid Disproportionate Share Hospital and the Upper Payment Limitation programs of \$5,891,122 and \$2,756,667 for the years ended December 31, 2008 and 2007, respectively. These amounts are reimbursements for providing care to the uninsured and underinsured.

The Hospital also has 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.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts deemed to be charity care are reported as deductions from revenues.

Combined Statements of Cash Flows

For purposes of the combined statements of cash flows, cash consists of unrestricted cash that is readily available for use in operations. Cash paid for interest, net of amount capitalized in 2008 and 2007 was \$2,511,891 and \$2,460,081 respectively. Capitalized interest was \$21,149 and \$241,208 for 2008 and 2007, respectively.

Inventories

Inventories are valued at the lower of cost (first-in, first-out method) or market.

Assets Whose Use is Limited

These assets include investments designated by the Hospital Board for internal purposes, investments and other assets restricted by donors for a specific purpose and investments held by trustees for debt service and continued construction projects.

Investments in Debt and Equity Securities

Investments in debt and equity securities are reported at fair value except for short-term highly liquid investments that have a remaining maturity at the time they are purchased of one year or less. These investments are carried at amortized cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating income when earned.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Capital Assets and Depreciation

Capital assets such as property and equipment are stated at cost and include expenditures for new additions and other costs added to existing facilities which exceed \$1,000 and meet certain useful life thresholds. Maintenance, repairs and minor renewals are expensed as incurred. The Hospital provides for depreciation of property and equipment using annual rates, which are sufficient to depreciate the cost of depreciable assets over their estimated useful lives using the straight-line method. The ranges of useful lives in computing depreciation include the following:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	8-15 years
Buildings and fixed equipment	5-40 years
Major movable equipment	3-20 years

Costs of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Bond Issuance Costs

The Hospital provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issuance costs are amortized over the life of the bond utilizing the straight-line method.

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, patient accounts receivable, assets whose use is limited, accounts payable, accrued liabilities, estimated third-party settlements and long-term debt. The carrying amounts reported in the combined balance sheets for cash and cash equivalents, patient accounts receivable, accounts payable, accrued liabilities and estimated third-party settlements approximate fair value. The fair values of assets whose use is limited are estimated based on quoted market prices for those or similar investments.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

The fair value of the Hospital's long-term debt is estimated based on market prices for similar issues on current rates offered to the Hospital. The fair value of the Revenue Bonds, Series 1996 and 2004 as of December 31, 2008 and 2007 approximated \$33,025,000 and \$46,017,000, respectively, with a carrying value of \$32,855,000 and 45,885,000, respectively. The fair value of the variable rate obligations is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements.

Federal or State Income Taxes

The Hospital is a governmental instrumentality organized under Title 16, Article 12, of the Indiana statutes. The Hospital is exempt from federal income tax as a unit of local government. Hancock Memorial Hospital Foundation, Inc. is a 501(c)(3) not-for-profit organization. Hancock Wellness, LLC is a limited liability company whereby, net taxable income is taxed directly to the members and not the Company.

Investments in Affiliates

The Hospital owns 50% of a Physician Hospital Organization (PHO) and Hancock Health Network, LLC, approximately 37% of Parkway, LLC, and approximately 46% of Hancock Regional Surgery Center, LLC. The investments are recorded on the equity method in the Hospital's combined financial statements. These separate financial statements may be obtained through contacting management of the Hospital.

Advertising and Community Relations

The Hospital records advertising and promotion expense in the period incurred. Total expense for advertising and promotion was \$61,749 and \$24,975 for 2008 and 2007, respectively.

Compensated Absences

The Hospital's employees earn time off at varying rates depending on years of service. The estimated amount of unused earned time off is reported as a liability in combined financial statements.

Reclassifications

Certain amounts from the 2007 financial statements have been reclassified to conform to the 2008 presentation.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

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.

Operating Revenues and Expenses

The Hospital's statement of operations and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services which is the Hospital's principal activity. Contributions, investment income, fund development costs and certain other non-healthcare activities are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Contributions

From time to time, the Hospital 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 either for specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating 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.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Litigation

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

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

2. CHARITY CARE

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. The charity care provided during 2008 and 2007 was \$4,948,981 and \$2,323,923, respectively.

3. INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

Board Designated Funds

The Hospital funds depreciation expense to meet the capital equipment needs of the facility. Depreciation is funded totally, with expenditures for capital equipment and debt principal payments reducing the funded depreciation balance. The Hospital designates other investments to fund specific projects. All interest earned by the funded depreciation and other board designated investment accounts are left to accumulate as an addition to the funds.

Donor Restricted Funds

The Hospital has assets which have been donated for a specific purpose.

Trustee Held Assets

The Hospital deposited investments with a trustee which will be utilized to provide for debt service and continued construction projects.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

The following represents assets whose use is limited and investments as of December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Board designated funds	\$ 24,479,910	\$ 27,195,277
Donor restricted funds	553,275	667,652
Trustee held assets for debt service	<u>4,240,828</u>	<u>6,619,141</u>
Total assets whose use is limited	29,274,013	34,482,070
Investments	<u>1,505,940</u>	<u>4,658,061</u>
	<u>\$ 30,779,953</u>	<u>\$ 39,140,131</u>
Hospital mutual funds - equities	\$ 13,073,979	\$ 17,849,054
Hospital mutual funds - fixed income	10,485,794	10,125,462
Foundation mutual funds - equities	811,065	1,475,397
Foundation mutual funds - fixed income	469,873	371,771
Certificates of deposit	168,968	195,763
Money market funds	3,125,436	6,371,948
Government securities	2,562,747	2,512,039
Other assets	<u>82,091</u>	<u>238,697</u>
	<u>\$ 30,779,953</u>	<u>\$ 39,140,131</u>

4. DEPOSITS AND INVESTMENTS

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 Public 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. Assets whose use is limited investments consist of cash equivalents, mutual funds and U.S. Government securities.

The Hospital'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.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

December 31, 2008

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Cash and money market funds	\$ 3,125,436	\$ 3,125,436	\$ -0-	\$ -0-	\$ -0-
Certificates of deposit	168,968	114,704	54,264	-0-	-0-
Mutual funds - equities	13,885,044	13,885,044	-0-	-0-	-0-
Mutual funds - fixed income	10,955,667	10,955,667	-0-	-0-	-0-
Government securities	2,562,747	-0-	-0-	-0-	2,562,747
Other assets	82,091	82,091	-0-	-0-	-0-
	<u>\$ 30,779,953</u>	<u>\$ 28,162,942</u>	<u>\$ 54,264</u>	<u>\$ -0-</u>	<u>\$ 2,562,747</u>

December 31, 2007

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Cash and money market funds	\$ 6,371,948	\$ 6,371,948	\$ -0-	\$ -0-	\$ -0-
Certificates of deposit	195,763	138,769	56,994	-0-	-0-
Mutual funds - equities	19,324,451	19,324,451	-0-	-0-	-0-
Mutual funds - fixed income	10,497,233	10,497,233	-0-	-0-	-0-
Government securities	2,512,039	-0-	-0-	-0-	2,512,039
Other assets	238,697	238,697	-0-	-0-	-0-
	<u>\$ 39,140,131</u>	<u>\$ 36,571,098</u>	<u>\$ 56,994</u>	<u>\$ -0-</u>	<u>\$ 2,512,039</u>

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.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

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

	<u>2008</u>	<u>2007</u>
Carrying amount		
Deposits	\$ 9,919,301	\$ 7,294,162
Investments	30,779,953	39,140,131
	<u>\$ 40,699,254</u>	<u>\$ 46,434,293</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 9,919,301	\$ 7,294,162
Investments	1,505,940	4,658,061
Current portion of assets whose use is limited	-0-	1,850,000
Board designated funds	24,479,910	27,195,277
Trustee held funds, less current portion	4,240,828	4,769,141
Donor restricted funds	553,275	667,652
	<u>\$ 40,699,254</u>	<u>\$ 46,434,293</u>

5. FAIR VALUE MEASUREMENTS

Statement on Financial Accounting Standards No. 157, Fair Value Measurements (as amended), 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 and 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 FAS 157 for fiscal year 2008, but will delay adoption of non-financial assets and non-financial liabilities covered by FASB Staff Position No. FAS 157-2. This Staff Position permits entities to partially defer the effective date of FAS 157 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 fiscal year 2009.

When fully adopted, the Hospital will apply the provisions of FAS 157-2 to certain non-financial assets and liabilities and is currently evaluating the impact of the full adoption of this statement on the activities, changes in net assets and financial position. Using the provisions within SFAS No. 157, 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.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Investments recorded in the combined balance sheets 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 include 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 U.S. Government securities and certificates of deposit.

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.

Based upon the levels as defined the Hospitals investments as of December 31, 2008 are classified as follows:

Investment Type	Fair value measurements at reporting date using:			
	December 31, 2008	Quoted prices in active markets for identical (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
U.S. Government Securities	\$ 2,562,747	\$ -0-	\$ 2,562,747	\$ -0-
Certificates of deposit	168,968	-0-	168,968	-0-
Mutual funds - equities	13,885,044	13,885,044	-0-	-0-
Mutual funds - fixed income	10,955,667	10,955,667	-0-	-0-
Money Market	3,125,436	3,125,436	-0-	-0-
Other assets	82,091	82,091	-0-	-0-
	<u>\$ 30,779,953</u>	<u>\$ 28,048,238</u>	<u>\$ 2,731,715</u>	<u>\$ -0-</u>

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

6. ACCOUNTS RECEIVABLE AND PAYABLE

Patient accounts receivable and accounts payable (including expenses) reported as current assets and liabilities as of December 31, 2008 and 2007 is as follows:

	2008	2007
Patient accounts receivable		
Receivable from patients and their insurance carriers	\$ 16,217,256	\$ 20,944,930
Receivable from Medicare	10,602,251	11,198,436
Receivable from Medicaid	1,871,723	2,777,338
Total patient accounts receivable	28,691,230	34,920,704
Less allowance for contractual agreements and uncollectible amounts	(20,605,247)	(23,641,077)
Patient accounts receivable, net	\$ 8,085,983	\$ 11,279,627
Accounts payable and accrued expenses		
Payable to employees (including payroll taxes and benefits)	\$ 4,567,422	\$ 3,509,997
Payable to suppliers	2,624,414	1,523,334
Accrued interest	764,343	1,095,691
Related party - Hancock Regional Surgery Center, LLC	2,373,858	-0-
Other	91,198	121,004
Total accounts payable and accrued expenses	\$ 10,421,235	\$ 6,250,026

7. INVESTMENTS IN AFFILIATES

The Hospital owns 50% of Hancock Health Network, LLC and has recorded the investment on the equity method of accounting in the amount of \$1,159,387 and \$790,223 as of December 31, 2008 and 2007, respectively. The Hospital paid physicians approximately \$257,000 and \$268,000 during 2008 and 2007, respectively for management and other operating expenses. The Hospital received \$443,000 and \$423,108 for 2008 and 2007, respectively from the Network for rental and housecleaning income. The Hospital contributed capital of \$1,685,547 and \$1,515,341 to the Network during 2008 and 2007, respectively. The Hospital has a receivable from the Network of \$31,613 and \$63,987 as of December 31, 2008 and 2007, respectively. The Hospital expects to continue providing capital contributions to the Network at a commensurate level with its past experience.

The Hospital owns approximately 37% of Parkway, LLC and has recorded the investment on the equity method of accounting in the amount of (\$82,154) and \$32,050 as of December 31, 2008 and 2007, respectively.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

The Hospital owns approximately 46% of Hancock Regional Surgery Center, LLC (Surgery Center) and has recorded the investment on the equity method of accounting in the amount of \$2,736,478 and \$2,803,730 as of December 31, 2008 and 2007, respectively.

8. CAPITAL ASSETS

Capital assets consist of the following as of December 31, 2008 and 2007:

	Balance December 31, 2007	Additions	Retirements	Transfers	Balance December 31, 2008
Land	\$ 270,285	\$ -0-	\$ -0-	\$ -0-	\$ 270,285
Land improvements	4,473,861	-0-	-0-	742,882	5,216,743
Buildings and fixed equipment	85,010,254	1,190,960	(169,447)	7,194,095	93,225,862
Major movable equipment	39,130,165	2,957,263	(1,772,878)	25,844	40,340,394
Construction in progress	7,543,450	963,129	-0-	(7,962,821)	543,758
Total property and equipment	136,428,015	5,111,352	(1,942,325)	-0-	139,597,042
Less accumulated depreciation					
Land improvements	(2,021,594)	(336,588)	-0-	-0-	(2,358,182)
Buildings and fixed equipment	(41,922,029)	(3,840,720)	132,143	-0-	(45,630,606)
Major movable equipment	(27,290,687)	(3,862,626)	1,720,401	-0-	(29,432,912)
Total accumulated depreciation	(71,234,310)	(8,039,934)	1,852,544	-0-	(77,421,700)
Property and equipment, net	<u>\$ 65,193,705</u>	<u>\$ (2,928,582)</u>	<u>\$ (89,781)</u>	<u>\$ -0-</u>	<u>\$ 62,175,342</u>
	Balance December 31, 2006	Additions	Retirements	Transfers	Balance December 31, 2007
Land	\$ 270,285	\$ -0-	\$ -0-	\$ -0-	\$ 270,285
Land improvements	4,470,048	-0-	-0-	3,813	4,473,861
Buildings and fixed equipment	84,212,720	658,070	(9,613)	149,077	85,010,254
Major movable equipment	37,783,709	1,714,936	(433,494)	65,014	39,130,165
Construction in progress	968,696	6,792,658	-	(217,904)	7,543,450
Total property and equipment	127,705,458	9,165,664	(443,107)	-0-	136,428,015
Less accumulated depreciation					
Land improvements	(1,709,963)	(311,631)	-0-	-0-	(2,021,594)
Buildings and fixed equipment	(38,027,633)	(3,896,354)	1,958	-0-	(41,922,029)
Major movable equipment	(23,685,360)	(3,994,362)	389,035	-0-	(27,290,687)
Total accumulated depreciation	(63,422,956)	(8,202,347)	390,993	-0-	(71,234,310)
Property and equipment, net	<u>\$ 64,282,502</u>	<u>\$ 963,317</u>	<u>\$ (52,114)</u>	<u>\$ -0-</u>	<u>\$ 65,193,705</u>

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

9. LONG-TERM DEBT

The Hospital issued tax-exempt revenue bonds, dated November 1, 1996, totaling \$20,065,000. The bonds matured serially on an annual basis through August 15, 2017 at interest rates ranging from 5.9% to 6.2%. Interest on these bonds was to be paid semi-annually on February 15 and August 15. Net revenues and certain assets held by the trustee secured the tax-exempt revenue bonds.

The Series 1996 bonds required the Hospital to maintain certain financial debt coverage ratios. As of December 31, 2008 and 2007, the Hospital was in compliance with the debt coverage ratios. During 2008, the Hospital paid off the remaining balance of the Series 1996 bonds with investment funds.

The Indiana Bond Bank (the "Bond Bank") issued Special Program Bonds, Series 2004 C (Hancock Memorial Hospital and Health Services Project) on June 1, 2004 pursuant to the provisions of a Trust Indenture with the Trustee, the Bank of New York Trust Company, NA, Indianapolis, Indiana in the aggregate principal amount of \$35,010,000.

The Bond Bank is the obligor to the bondholders. The bonds are insured. The proceeds from the sale of the Series 2004 C Bonds were used to provide funds to (a) purchase Series 2004 C Qualified Obligations in the amount of \$34,475,000, (b) provide a credit facility for the Debt Service Reserve fund, (c) pay a portion of the interest on the Series 2004 C Bonds, (d) pay the premium for bond insurance, and (e) pay all of the Costs of Issuance of the Series 2004 C Bonds, including the underwriters discount.

The Hancock County Hospital Association (the "Association") was created in 2004 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. The Association issued the Series 2004 C Qualified Obligations pursuant to a Trust Indenture dated June 1, 2004 between the Association and the Trustee.

The net proceeds from the Series 2004 C Qualified Obligations are to be used for Hospital additions and improvements which will include a new Emergency Department, Intensive Care and Cardiac Care Center and expansion of space for future hospital and healthcare needs.

The Board of Trustees of the Hospital and Hancock County, Indiana, acting through its Board of Commissioners are lessees (collectively, the "Lessee") under a lease agreement dated April 1, 2004 (the "Lease") with the Association (the "Lessor") for the Hospital additions and improvements (the "Leased Premises").

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

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 2004 C Obligations. The County and the Hospital anticipate that the full lease rental payments will be paid from Hospital revenues.

The Series 2004 C Obligations and the Lease have essentially the same terms with interest rates ranging from 2.94% to 5.52% to be paid semi-annually on January 15 and July 15 through January 15, 2031. The Trust Indenture has certain compliance requirements for which the Hospital believes it is in compliance. The lease rental revenues are pledged to secure the Series 2004 C obligations.

Long-term debt as of December 31, 2008 and 2007 includes the following:

	Balance December 31, 2007	Additions	Reductions	Balance December 31, 2008	Current Portion	Long-Term Portion
The Series 2004 C Obligations Capital Lease	\$ 33,680,000	\$ -0-	\$ (825,000)	\$ 32,855,000	\$ 850,000	\$ 32,005,000
Indiana Health Facility Financing Authority, series 1996	12,205,000	-0-	(12,205,000)	-0-	-0-	-0-
Note payable; due January 4, 2021; interest rate at 6.75%; real estate and property as collateral	2,031,846	-0-	(2,031,846)	-0-	-0-	-0-
Less: unamortized loss on refunding	(620,094)	-0-	620,094	-0-	-0-	-0-
Total long-term debt	\$ 47,296,752	\$ -0-	\$ (14,441,752)	\$ 32,855,000	\$ 850,000	\$ 32,005,000
	Balance December 31, 2006	Additions	Reductions	Balance December 31, 2007	Current Portion	Long-Term Portion
The Series 2004 C Obligations Capital Lease	\$ 34,475,000	\$ -0-	\$ (795,000)	\$ 33,680,000	\$ 825,000	\$ 32,855,000
Indiana Health Facility Financing Authority, series 1996	13,170,000	-0-	(965,000)	12,205,000	1,025,000	11,180,000
Note payable; due January 4, 2021; interest rate at 6.75%; real estate and property as collateral	2,110,330	-0-	(78,484)	2,031,846	82,533	1,949,313
Less: unamortized loss on refunding	(737,416)	-0-	117,322	(620,094)	(110,568)	(509,526)
Total long-term debt	\$ 49,017,914	\$ -0-	\$ (1,721,162)	\$ 47,296,752	\$ 1,821,965	\$ 45,474,787

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Aggregate maturities of long-term debt are as follows:

Year Ending December 31,	Principal	Interest	Total
2009	\$ 850,000	\$ 1,656,772	\$ 2,506,772
2010	880,000	1,625,058	2,505,058
2011	920,000	1,590,294	2,510,294
2012	960,000	1,552,271	2,512,271
2013	1,000,000	1,511,015	2,511,015
2014-2018	5,720,000	6,822,029	12,542,029
2019-2023	7,285,000	5,252,603	12,537,603
2024-2028	9,455,000	3,075,078	12,530,078
2029-2032	5,785,000	487,692	6,272,692
	<u>\$ 32,855,000</u>	<u>\$ 23,572,812</u>	<u>\$ 56,427,812</u>

10. PATIENT SERVICE REVENUE

Patient service revenue for 2008 and 2007 consists of the following:

	2008	2007
Inpatient	\$ 55,219,964	\$ 49,556,266
Outpatient	111,884,301	98,067,607
Transitional Care/Inpatient Rehabilitation	4,906,732	4,936,680
Geriatric Psychiatric	3,724,495	3,494,860
Gross patient service revenue	<u>175,735,492</u>	<u>156,055,413</u>
Contractual allowance	73,662,888	67,890,566
Bad debts	7,368,141	6,705,779
Charity care	4,948,981	2,323,923
Deductions from revenue	<u>85,980,010</u>	<u>76,920,268</u>
Net patient service revenue	<u>\$ 89,755,482</u>	<u>\$ 79,135,145</u>

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

11. DONOR RESTRICTED NET ASSETS

Donor restricted net assets are available for the following purposes:

	<u>2008</u>	<u>2007</u>
Specific purpose funds	<u>\$ 553,275</u>	<u>\$ 667,652</u>

Restricted funds include donations to the Foundation that have been restricted by donors for a specific purpose. Generally, these donations are for additions to Hospital property and equipment. Transfers are made to unrestricted funds as expenditures are made in accordance with the donor restrictions.

12. PENSION PLAN

The Hospital offers a defined contribution plan that covers all employees who meet eligibility requirements as to age and length of service and who elect to participate. The Hospital matches 50% of the employee contribution up to 4% of the eligible wages. Pension expense related to the defined contribution plan was \$1,049,740 and \$1,064,594 in 2008 and 2007, respectively.

13. CONCENTRATION OF CREDIT RISK

The Hospital is located in Greenfield, Indiana. The Hospital grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31 was as follows:

	<u>2008</u>	<u>2007</u>
Medicare	37%	32%
Medicaid	7%	8%
Other third-party payors	30%	34%
Patients	26%	26%
	<u>100%</u>	<u>100%</u>

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

14. SELF INSURANCE

The Hospital is self insured for employee health claims. A third party administrator processes the claims for the Hospital. The Hospital maintains an estimated liability for the amount of claims incurred but not reported. The Hospital maintains reinsurance including a stop loss for specific incident claims over \$150,000 and an employee life time maximum of \$1,000,000. Substantially all employees are covered for major medical benefits. The total health claims expense was \$5,026,913 and \$5,008,062 for 2008 and 2007, respectively.

Claim expenditures and liabilities 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 balance of health claim liabilities during the past two years are as follows:

	<u>2008</u>	<u>2007</u>
Unpaid claims estimate, beginning of year	\$ 722,437	\$ 613,397
Incurred claims and changes in estimates	5,026,913	5,008,062
Claims payments	<u>(4,430,687)</u>	<u>(4,899,022)</u>
Unpaid claims estimate, end of year	<u>\$ 1,318,663</u>	<u>\$ 722,437</u>

15. POSTEMPLOYMENT HEALTHCARE PLAN

The Hospital's defined benefit postemployment healthcare plan, Hancock Regional Hospital Postemployment Healthcare Plan (HRHPHP), provides medical benefits to eligible retired employees and their beneficiaries. The Hospital's estimated obligation to the HRHPHP is approximately \$800,000 as of December 31, 2008 representing the present value of the estimated future cash flows.

HANCOCK REGIONAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

16. COMMITMENTS AND CONTINGENCIES

Malpractice Insurance

The Indiana Medical Malpractice Act, IC 27-12 (the Act), provides a recovery for an occurrence of malpractice and for any injury or death of a patient due to an act of malpractice in excess of certain thresholds. The Act requires the Hospital to maintain medical malpractice liability insurance on a per occurrence basis and in the annual aggregate for amounts below the thresholds of the Act. During 2001, the Hospital's malpractice carrier filed bankruptcy. The Hospital has obtained malpractice coverage through another carrier. The Hospital may be liable for certain pending claims incurred while with the former carrier. Management is not aware of any related material adverse effects to its financial condition. Prior to July 1, 1999, the Indiana Medical Malpractice Act provided for a maximum recovery of \$750,000 per occurrence (\$3,000,000 annual aggregate) for professional liability, \$100,000 of which would be paid through the Hospital's malpractice insurance coverage and the balance would be paid by the State of Indiana Patient Compensation Fund. For claims on or after July 1, 1999, the Indiana Medical Malpractice Act provides for a maximum recovery of \$1,250,000 per occurrence (\$7,500,000 annual aggregate) with the first \$250,000 covered by the Hospital's insurance and the remainder by the Fund.

Effective July 1, 2006, the Hospital became a member in a captive insurance company, Suburban Health Organization Segregated Portfolio Company, LLC, to fund the Hospital's required portion of the professional and physician insurance coverage pursuant to the Act as well as its general liability insurance and excess coverage.