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HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2008 AND 2007

CPA ADVISORS

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HOWARD REGIONAL HEALTH SYSTEM

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Howard Regional Health System
Kokomo, Indiana

We have audited the accompanying consolidated balance sheets of Howard Regional Health System (the System), as of December 31, 2008 and 2007, and the related consolidated statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of the Howard Regional Health System Foundation, Inc. (the Foundation), a blended component unit, whose statements reflect total assets of \$4,196,782 and \$5,168,664 as of December 31, 2008 and 2007, respectively, and change in net assets of \$(621,908) and \$98,985, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and in our opinion, insofar as it relates to the amounts for the Foundation, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, issued by the Comptroller General of the United States, Guidelines for Examination of Entities Receiving Financial Assistance From Governmental Sources and 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

Board of Trustees
Howard Regional Health System
Kokomo, Indiana

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the System as of December 31, 2008 and 2007 and the results of its consolidated 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 as listed in the accompanying table of contents, is not a required part of the basic consolidated 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 consist 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.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The consolidating statements as listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have issued, under separate cover, our report dated July 29, 2009, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

Blue & Co., LLC

July 29, 2009

REQUIRED SUPPLEMENTARY INFORMATION

HOWARD REGIONAL HEALTH SYSTEM

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

This section of Howard Regional Health System's (the System) annual consolidated financial statements presents background information and management's discussion and analysis of the System's consolidated financial performance during the year ended December 31, 2008. This MD&A includes a discussion and analysis of the activities and results of the System, its blended component unit, Howard Regional Health System Foundation, and its majority owned subsidiaries as described in the notes to the consolidated financial statements.

This MD&A should be read together with the consolidated financial statements included in this report.

The System has two county-owned facilities and operates under the Indiana County Hospital Law, Indiana Code 16-22. It has a licensed and staffed 150-bed acute regional hospital and a 30-bed regional rehabilitation hospital both located in Kokomo, Indiana serving a nine county region in north central Indiana. The System provides short-term inpatient and outpatient health care among other services.

The Board of County Commissioners of Howard County appoints the Governing Board of the System and a financial benefit/burden relationship exists between the County and the System. For these reasons, the System is considered a component unit of Howard County.

HIGHLIGHTS OF THE YEAR ENDED DECEMBER 31, 2008

Howard Regional Health System continues to be the hospital market share leader in Howard County offering a full range of inpatient and outpatient services. Even adjusting for a decline in volumes, the System continues to be the third largest employer in Howard County with two hospitals on three campuses plus clinics in Greentown, Peru, Frankfort and Tipton.

Work began early 2008 on the System's 2009-2012 strategic plan, which focuses on five major areas:

1. Outstanding quality
2. Superior service
3. Exceptional people
4. Ongoing growth
5. Consistent strength

Task forces comprised of Trustees, Administrative Council, physician representatives and members of the management team worked to identify key opportunities for future growth. The plan was approved at the December 2008 meeting of the Board of Trustees. Inherent in this plan is the introduction of a rewritten mission: To provide exceptional quality, patient-centered care.

HOWARD REGIONAL HEALTH SYSTEM

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

Physician Recruitment

The employment of physicians and physician groups is a strategic measure many hospitals are taking to help build patient volumes. Over the past decade, one of the System's strategies has been to recruit and secure relationships with primary care physicians. This strategy was behind the formation of Community Family Health Center, North Central Indiana Pediatric Center, Community OB/GYN Center and our internal medicine practices.

In order to fulfill our primary mission of providing exceptional quality care, we have made a commitment to further expand and secure a solid base of primary care physicians. As a result, Dr. Timothy Gatewood, Dr. Alnasir P. Virjee, Dr. Sadia M. Dar and Dr. Ryan Trauring all joined the System's staff in 2008.

The System also successfully recruited several specialists during 2008: Dr. Lawrence Gering, electrophysiologist; Dr. Krishnan Rajagopal, pulmonologist; Dr. John Salter, medical oncologist; Dr. John Schiltz, child and adolescent psychiatrist; Dr. Carol Sheridan, general surgeon; Dr. Damir Matesic, allergist and immunologist; and Dr. Joel Underwood, cardiac anesthesiologist.

Reorganization

A 2008 reorganization of several areas of the System was one way we addressed the financial and operational challenges we and other hospitals around the country face. This reorganization was designed to flatten the reporting structure, reducing the layers between staff and upper management. This will improve communication, streamline accountability and create operating efficiencies.

Facility Growth

Positioning for the future, we continued our strategic plan for facility growth both within the Main Campus hospital and in outpatient areas.

Imaging Center of North Central Indiana

The System took over operation of the Imaging Center of North Central Indiana on January 1, 2008. Doing so allowed us to begin offering inpatient MRI services at our Main Campus, addressing patient safety and quality of care issues and, at the same time, realizing some operational efficiencies. In addition to the outpatient services available at the Imaging Center, several concepts to expand the use of this facility for the continued growth of services important to our community are being discussed.

HOWARD REGIONAL HEALTH SYSTEM

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

Birthing Center and Medical Surgical Rooms

In January 2008, we opened our new 9,702 square foot Birthing Center and new 7,899 square foot Medical/Surgical Unit. These new units added 29 new private rooms to the hospital, 16 post partum rooms and 13 Medical Surgical rooms. Additionally, the new Birthing Center added two additional labor/delivery/recovery rooms for a total of eight.

Pediatric Unit

The Pediatric Unit relocated to the space vacated by the old Birthing Center in early summer 2008. This unit includes ten private rooms, a children's playroom and a treatment room. This refurbished unit, designed for the comfort and safety of children, also provides "overflow" rooms for our Medical/Surgical unit.

Medical Office Building

In early fall 2008, we opened a new medical office building adjacent to our West Campus Specialty Hospital. This facility houses Kokomo Pulmonary and allows that growing practice to expand.

Technology Center

In late summer, the System began construction on an expansion of its Technology Center at the Main Campus Annex Building, 3548 South Lafountain. The additional space will be used by the System to support its growth and advancement in medical and information technology offerings and to house the System's departments that provide technology services.

Charity Care

The System provided \$8,199,000 of charity care to the community in 2008. This compares to \$6,827,000 in 2007 or a 20% increase.

New Services

Inpatient MRI

In years past, our inpatient population traveled to the Imaging Center for their MRI testing. In January 2008, we started offering Inpatient MRI services to enhance patient safety and turn-around time.

HOWARD REGIONAL HEALTH SYSTEM

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

Electrophysiology

In December 2008, the System added electrophysiology to its comprehensive cardiology program. The System is the first hospital in the region to have an electrophysiology program. Electrophysiology is a cardiac subspecialty dedicated to treating heart rhythm disorders called arrhythmia. Dr. Lawrence Gering was recruited to direct this program.

Wound Clinic

After dissolution of a partnership with Curative Network for the provision of wound care services, Howard began its own wound clinic at 408 East Southway. The Wound Clinic provides treatment for chronic or non-healing wounds.

Market Risk

Marketable Securities

We are exposed to market risk related to changes in value of securities. The investment in mutual fund fixed income and equity securities was \$14.98 million at December 31, 2008. These investments are carried at fair value, with changes in unrealized gains and losses being recorded in investment income (loss). During 2008, we had a net unrealized loss of \$7.57 million on our investment securities.

Interest Rate Swap Agreements

We are exposed to market risk related to changes in interest rates and we entered into interest rate swap agreements to manage our exposure to these fluctuations. Our interest rate swap agreements involve the exchange of fixed and variable rate interest payments between two parties, based on common notional principal amounts and maturity dates. The notional amounts of the swap agreements represent balances used to calculate the exchange of cash flows. Our credit risk related to these agreements is considered low because the swap agreements are with creditworthy financial institutions. The interest payments under these agreements are settled on a net basis. These derivatives have been recognized in the financial statements at their respective fair value. Changes in the fair value of these derivatives are included in the statement of revenues, expenses and changes in net assets. During 2008, the System recognized an unrealized loss on the swap agreements of \$7.66 million.

HOWARD REGIONAL HEALTH SYSTEM

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

LOOKING AHEAD TO 2009

We continue to make plans to convert to an electronic medical record system. With an EMR, complete near real-time records can be viewed anytime from anywhere in the secure network, and records can be accessed concurrently by caregivers who have a need to view the information in the provision of care. Faster access from more places means caregivers have the most current information at their fingertips to make quick and evidence-based healthcare decisions.

Quality, patient safety and patient satisfaction will continue to be priorities at the System in the year and years ahead. Working with guidelines provided by state and national healthcare organizations, we are committed to providing exceptional quality, patient-centered care.

CONSOLIDATED FINANCIAL STATEMENTS

The System's consolidated financial statements consist of three statements - a consolidated balance sheet; a consolidated statement of revenues, expenses and changes in net assets; and a consolidated statement of cash flows. The consolidated balance sheet includes all of the System's assets and liabilities, including assets held by the System but restricted for specific purposes by contributors, grantors, or enabling legislation. The consolidated balance sheet provides a basis for computing rate of return, evaluating the capital structure of the System, and assessing the liquidity and financial flexibility of the System. The consolidated statement of revenues, expenses and changes in net assets includes all revenues and expenses of the System. This statement measures the consolidated financial results of the System's operations and presents revenue earned and expenses incurred. The consolidated statement of cash flows provides information about the System's cash flows from operating activities, capital and related financing activities, and investing activities, and provides information on the sources and uses of cash during the year.

HOWARD REGIONAL HEALTH SYSTEM

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

FINANCIAL PERFORMANCE

A summary of the System's consolidated statements of revenues, expenses and changes in net assets follows:

Summary of Operations	2008		2007	
	Amount	Ratio	Amount	Ratio
Total revenues	\$ 156,318,178	100.0%	\$ 163,331,507	100.0%
Salaries and benefits	82,886,775	53.0%	81,262,901	49.8%
Supplies and drugs	28,924,823	18.5%	31,704,683	19.4%
Purchased services	9,168,827	5.9%	10,117,743	6.2%
Depreciation and amortization	9,744,425	6.2%	7,484,888	4.6%
Other	27,375,982	17.5%	27,057,443	16.6%
Total operating expenses	158,100,832	101.1%	157,627,658	96.5%
Operating income (loss)	(1,782,654)	-1.1%	5,703,849	3.5%
Nonoperating revenues (expenses), net and other changes in net assets	(20,634,262)	-13.2%	(2,693,532)	-1.6%
Change in net assets	(22,416,916)	-14.3%	3,010,317	1.8%
Net assets, beginning of year	88,542,430		85,532,113	
Net assets, end of year	\$ 66,125,514		\$ 88,542,430	

During 2008, the System derived substantially all of its revenue from patient services 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.

In 2008, the System received approximately \$1.7 million from the Medicaid Disproportionate Share and Municipal Upper Payment Programs compared to \$9.3 million in 2007. This change makes up the majority of the decline in total revenues for 2008.

HOWARD REGIONAL HEALTH SYSTEM

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

Other financial performance indicators include:

Cash Flows Data	2008	2007
From operating activities	\$ 12,872,769	\$ 6,802,812
From capital and related financing activities	\$ (18,608,408)	\$ (27,247,635)
From investing activities	\$ 2,441,441	\$ 642,609
 Financial Position		
Total assets	\$ 157,696,392	\$ 174,433,935
Net capital assets	\$ 89,318,608	\$ 84,931,207
Total liabilities	\$ 88,980,769	\$ 82,737,828
Long term debt, including current portion	\$ 64,091,454	\$ 62,777,717
 Net assets		
Invested in capital assets, net of related debt	\$ 27,062,187	\$ 28,571,067
For debt service	1,902,142	6,513,975
Expendable for capital improvements	6,409,051	8,472,795
Expendable for other specific purposes	10,885	12,440
Held by Foundation	2,911,877	3,533,785
Unrestricted	27,829,372	41,438,368
Total net assets	\$ 66,125,514	\$ 88,542,430
 Days cash on hand		
	82	105
 Operating data		
Number of staffed beds	180	180
Inpatient discharges	6,354	6,542
Average daily census	80.1	85.6
Acute average length of stay	4.2	4.3
Occupancy	47.1%	57.1%
Medicare inpatient case mix	1.48	1.44
Adjusted patient days	87,362	93,240

The System's revenues depend upon inpatient occupancy levels, the ancillary services and therapy programs ordered by physicians and provided to patients, the volume of outpatient procedures and the negotiated payment rates for such services. The gross charges typically do not reflect what is actually paid. The System has entered into agreements with third party payers, including government programs and managed care health plans, under which payments for healthcare services provided to patients are based upon predetermined rates per diagnoses or discounts from gross charges. The System receives a significant portion of its revenues from government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. Revenues from Medicare and Medicaid programs decreased to 55.6% of gross revenues in 2008 from 55.4% in 2007. Legislative changes continue to limit or reduce the levels of payments from these programs.

HOWARD REGIONAL HEALTH SYSTEM

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

The approximate percentages of gross patient revenues were:

	<u>2008</u>	<u>2007</u>
Medicare	45.9%	45.2%
Medicaid	9.7%	10.2%
Blue Cross/Blue Shield	22.7%	20.5%
Commercial	14.4%	17.1%
Other	7.3%	7.0%
	<u>100.0%</u>	<u>100.0%</u>

LONG TERM DEBT

As of December 31, 2008, the System had \$64.1 million in short term and long term notes and bonds outstanding, an increase from the \$62.8 million as of December 31, 2007. The increase relates to the consolidation of the Imaging Center of North Central Indiana with the System's financial statements for 2008. The System restructured its debt and greatly increased its borrowings in 2005 to fund capital projects for the next several years and position the System for future growth. More detailed information about the System's long term debt is presented in the notes to the consolidated financial statements.

ECONOMIC OUTLOOK

Management believes that the healthcare industry operating margins will continue to be under significant pressure because of changes in payer mix and growth in operating expenses in excess of the increase in prospective payments under the Medicare and Medicaid programs. The ongoing challenge facing the System and the entire healthcare market is to continue to provide quality patient care in a competitive environment and to attain reasonable rates for the services it provides while managing its costs. The most significant cost factor affecting the System and the industry in general is the spiraling increase in labor costs due to a nationwide shortage of nurses and other healthcare specialists. The System expects the nursing shortage to continue and has implemented various initiatives to better position itself to attract and retain qualified nursing personnel and improve productivity.

CONTACTING THE SYSTEM'S FINANCIAL MANAGEMENT

This report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the System at 3500 South Lafountain Street, Kokomo, Indiana 46904, (765) 453-0702.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 11,937,369	\$ 11,153,741
Investments	15,674,767	21,271,032
Patient accounts receivable, net of estimated uncollectibles of \$10,145,303 in 2008 and \$9,776,697 in 2007	21,132,109	23,236,941
Other receivables	3,056,842	2,980,747
Inventory and other current assets	5,755,620	5,371,841
Estimated third party settlements	122,728	5,997,457
Current portion of assets whose use is limited	820,000	800,000
Total current assets	<u>58,499,435</u>	<u>70,811,759</u>
Assets whose use is limited		
Internally designated	6,409,051	8,472,795
Held by trustee	1,902,142	6,513,975
Total assets whose use is limited	<u>8,311,193</u>	<u>14,986,770</u>
Less current portion	820,000	800,000
Noncurrent portion of assets whose use is limited	<u>7,491,193</u>	<u>14,186,770</u>
Capital assets, net	89,318,608	84,931,207
Other assets	<u>2,387,156</u>	<u>4,504,199</u>
Total assets	<u>\$ 157,696,392</u>	<u>\$ 174,433,935</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2008 AND 2007

LIABILITIES AND NET ASSETS

	<u>2008</u>	<u>2007</u>
Current liabilities		
Accounts payable and accrued expenses	\$ 4,468,625	\$ 6,476,384
Accrued liabilities	10,273,466	10,375,648
Other current liabilities	1,625,104	2,123,852
Current portion of revenue bonds payable	820,000	1,025,044
Current portion of loans payable	1,042,995	394,015
Current portion of capital lease obligations	691,520	-0-
Total current liabilities	<u>18,921,710</u>	<u>20,394,943</u>
Long term debt		
Revenue bonds payable	48,075,000	49,995,794
Loans payable	13,461,939	11,362,864
Total long term debt	<u>61,536,939</u>	<u>61,358,658</u>
Other long term liabilities	<u>8,522,120</u>	<u>984,227</u>
Total liabilities	88,980,769	82,737,828
Minority interest	2,590,109	3,153,677
Net assets		
Invested in capital assets, net of related debt	27,062,187	28,571,067
Restricted		
For debt service	1,902,142	6,513,975
Expendable for capital improvements	6,409,051	8,472,795
Expendable for other specific purposes	10,885	12,440
Held by Foundation	2,911,877	3,533,785
Total restricted net assets	<u>11,233,955</u>	<u>18,532,995</u>
Unrestricted	<u>27,829,372</u>	<u>41,438,368</u>
Total net assets	<u>66,125,514</u>	<u>88,542,430</u>
Total liabilities and net assets	<u>\$ 157,696,392</u>	<u>\$ 174,433,935</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

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

	2008	2007
Revenues		
Net patient service revenue	\$ 142,168,617	\$ 149,508,790
Other	14,149,561	13,822,717
Total revenues	156,318,178	163,331,507
Operating expenses		
Salaries and wages	68,149,272	65,960,300
Employee benefits	14,737,503	15,302,601
Medical professional fees	4,516,515	5,444,828
Medical supplies and drugs	28,924,823	31,704,683
Purchased services	9,168,827	10,117,743
Equipment rentals	8,512,114	7,154,997
Utilities and telephone	3,052,936	2,730,635
Insurance	1,218,909	1,073,165
Depreciation and amortization	9,744,425	7,484,888
Other	10,075,508	10,653,818
Total expenses	158,100,832	157,627,658
Operating income (loss)	(1,782,654)	5,703,849
Nonoperating revenues (expenses)		
Investment income (loss)	(7,029,464)	2,724,550
Interest expense	(3,343,341)	(2,082,089)
Unrealized loss on derivatives	(7,659,767)	(1,132,195)
Other nonoperating expenses	(734,586)	(387,235)
Nonoperating revenues (expenses), net	(18,767,158)	(876,969)
Excess (deficit) revenues over expenses before minority interest	(20,549,812)	4,826,880
Minority interest	(1,867,104)	(1,816,563)
Change in net assets	(22,416,916)	3,010,317
Net assets		
Beginning of year	88,542,430	85,532,113
End of year	\$ 66,125,514	\$ 88,542,430

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

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

	2008	2007
Operating activities		
Cash received from patients and third party payors	\$ 150,148,178	\$ 144,162,649
Cash paid to vendors for goods and services	(66,530,436)	(67,805,755)
Cash paid for employee wages and benefits	(84,894,534)	(82,687,440)
Other receipts, net	14,149,561	13,133,358
Net cash flows from operating activities	12,872,769	6,802,812
Capital and related financing activities		
Acquisition and construction of capital assets	(10,256,962)	(21,947,954)
Loss on disposal of property and equipment	430,439	144,706
Minority interest	(1,867,104)	(1,816,563)
Interest on long term debt	(3,343,341)	(2,082,089)
Borrowings on long term debt	1,110,805	-0-
Principal paid on long term debt	(4,682,245)	(1,545,735)
Net cash flows from capital and related financing activities	(18,608,408)	(27,247,635)
Investing activities		
Investment income (loss)	(7,029,464)	2,724,550
Investment in affiliated companies, net	2,117,043	(539,903)
Other nonoperating revenues and expenses	(734,586)	(387,235)
Other changes in investments and assets whose use is limited	8,088,448	(1,154,803)
Net cash flows from investing activities	2,441,441	642,609
Net change in cash and cash equivalents	(3,294,198)	(19,802,214)
Cash and cash equivalents, beginning of year	18,227,299	38,029,513
Cash and cash equivalents, end of year	<u>\$ 14,933,101</u>	<u>\$ 18,227,299</u>
Reconciliation of cash and cash equivalents		
In current assets	\$ 11,937,369	\$ 11,153,741
In investments	695,812	529,471
In assets whose use is limited - internally designated	397,778	30,112
In assets whose use is limited - held by trustee	1,902,142	6,513,975
Cash and cash equivalents, end of year	<u>\$ 14,933,101</u>	<u>\$ 18,227,299</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

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

	2008	2007
Reconciliation of operating income (loss) to net cash flows from operating activities		
Operating income (loss)	\$ (1,782,654)	\$ 5,703,849
Adjustments to reconcile operating income (loss) to net cash flows from operating activities		
Depreciation and amortization	9,744,425	7,484,888
Bad debts	9,859,435	9,190,107
Changes in operating assets and liabilities		
Patient accounts receivable	(7,754,603)	(8,799,111)
Other receivables	(76,095)	1,189,716
Estimated third party settlements	5,874,729	(5,294,301)
Inventory and other assets	(383,779)	(1,938,157)
Accounts payable and accrued expenses	(2,007,759)	(1,424,539)
Accrued liabilities and other liabilities	(102,182)	447,872
Other current liabilities	(498,748)	242,488
Net cash flows from operating activities	\$ 12,872,769	\$ 6,802,812
Supplemental disclosures of cash flow information		
Cash paid for interest, net of capitalized interest of \$275,000 in 2008 and \$885,000 in 2007	\$ 3,445,523	\$ 1,634,217
Noncash capital and related financing activities		
Capital asset purchases in accounts payable	\$ -0-	\$ 254,423
Capital lease obligations incurred for use of capital assets	\$ 128,000	\$ -0-
Net capital assets transferred from subsidiary	\$ 5,485,409	\$ -0-
Debt and capital lease obligations transferred from subsidiary	\$ 4,757,177	\$ -0-

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Howard Regional Health System (the System) is a county-owned facility and operates under the Indiana County Hospital Law, Indiana Code 16-22. The System provides short-term inpatient and outpatient health care among other services. The Board of County Commissioners of Howard County appoints the Governing Board of the System and a financial benefit/burden relationship exists between the County and the System. For these reasons, the System is considered a component unit of Howard County.

Accounting principles generally accepted in the United States of America require that these consolidated financial statements present the System (primary government) and its significant component units. The component units discussed below are included in the System's reporting entity because of the significance of their operational or financial relationships with the System. Blended component units, although legally separate entities are in substance part of the government's operations and exist solely to provide services for the government; data from these units is combined with data of the primary government.

Blended Component Units

Howard Regional Health System Foundation, Inc. (the Foundation) is a blended component unit of the System. The Foundation is a separate not-for-profit entity organized to support the operations of the System. Financial statements for the Foundation can be obtained by contacting the Foundation office.

Other component units included in the consolidated financial statements based on the System's control of these entities are Howard Regional Specialty Care, LLC, Midwest Racquetball, Inc. dba Kokomo Sports Center and Howard Community Surgery Center, LLC. During 2008, The Imaging Center of North Central Indiana, Inc. became a wholly owned subsidiary of the System and is consolidated in 2008. These entities have been consolidated for financial statement presentation.

All significant intercompany transactions have been eliminated in the consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Use of Estimates

The preparation of consolidated 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 disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Enterprise Fund Accounting

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

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System 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.

Investments

Certificates of deposit, demand deposits and similar negotiable instruments that are not reported as cash and cash equivalents are reported as investments at cost or amortized cost which approximates fair value.

Mutual funds are reported at fair value based on the fund's market price. Other money market investments are reported at fair value.

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating income in the consolidated statements of revenues, expenses and changes in net assets.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Patient Accounts Receivable and Revenues

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. The System is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The System is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG). The System 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. At the System's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. These programs have audited the year-end cost report filed with the Medicare program through December 31, 2006 with differences reflected as deductions from revenue in 2008. During 2008 and 2007, the System recognized approximately \$43,000 and \$93,000, respectively, to income due to the differences between original estimates and subsequent revisions for the final settlement of cost reports.

Management estimates an allowance for uncollectible patient accounts receivable based on an evaluation of historical losses, current economic conditions, and other factors unique to the System's customer base.

Charity Care

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

Inventory

Inventory is valued at the lower of cost or market with cost being determined on the first-in, first-out (FIFO) method.

Assets Whose Use is Limited

Assets whose use is limited are stated at fair market value in the consolidated financial statements. These assets include investments designated by the System's Board of Trustees for internal purposes, investments restricted by donors for a specific purpose and investments held by trustees for debt service and capital expenditures. These investments consist primarily of cash and cash equivalents, certificates of deposit, US government securities and mutual funds.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Investment interest, dividends, gains and losses, both realized and unrealized are included in nonoperating revenues (expenses) in the consolidated statements of revenues, expenses and changes in net assets.

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 \$500 and meet certain useful life thresholds. Maintenance, repairs and minor renewals are expensed as incurred. The System 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 range of useful lives in computing depreciation is as follows:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	15 years
Buildings and fixed equipment	4-50 years
Major moveable equipment	5-15 years

Net Assets

Net assets of the System 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 noncapital net assets that must be used for a particular purpose, as specified by creditors or donors outside the System, including amounts deposited with trustees as required by revenue bond indentures, amounts designated for capital improvements and net assets held by the Foundation. Unrestricted net assets are remaining net assets that do not meet the definition of net assets invested in capital assets net of related debt or restricted net assets.

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

The System's consolidated statements of revenues, expenses and changes in net assets distinguish between operating and nonoperating revenues and expenses. For purposes of display, transactions deemed by management to be ongoing, major or central to the provision of healthcare services are reported as revenues and expenses. Peripheral or incidental transactions such as investment activities are reported as nonoperating gains or losses.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Consolidated Statements of Cash Flows

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less from the date of purchase. Capitalized interest expense was \$275,000 and \$885,000 for 2008 and 2007, respectively. Capitalized interest income was \$50,000 and \$591,000 for 2008 and 2007, respectively.

Cost of Borrowing

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

Bond Issue Costs

The System provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs net of accumulated amortization were \$618,104 and \$656,701 as of December 31, 2008 and 2007, respectively.

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 consolidated 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. The fair value of the System's long-term debt is estimated based on market prices for similar issues on current rates offered to the System. As of December 31, 2008 and 2007, the carrying value of the System's long-term debt approximated its fair value.

The System holds Level 1 investments, in which fair market values are readily determinable using quoted prices in active markets for identical assets as determined by FAS 157: *Fair Value Measurements*. Level 2 investments fair market values are determined by significant other observable inputs.

Federal or State Income Taxes

The System is exempt from taxation as a not-for-profit organization under the Internal Revenue Code as an extension of the county government and, therefore, no provision for income taxes has been made.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Accounting for Uncertainty in Income Taxes

The Financial Accounting Standards Board ("FASB") has 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 System has 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 System evaluates uncertain tax positions in accordance with existing generally accepted accounting principles and makes such accruals and disclosures as might be required thereunder.

Compensated Absences

The System's policy on compensated absences (which include vacation, sick leave and holidays) allows full time employees and regular part time employees to accrue days off, to a maximum of 480 hours. Compensated absences are accrued when incurred and reported as a liability on the consolidated balance sheets.

Advertising Costs

The System's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were \$1,081,744 and \$1,205,442 in 2008 and 2007, respectively.

Litigation

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

Risk Management

The System 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, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Medical Malpractice Claims

The System participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the System, with the balance paid by the State of Indiana Patient Compensation Fund. The System carries an occurrence basis insurance policy covering the System's \$250,000 of exposure per claim. Accordingly, the System has not recorded any provision of self-insured medical malpractice claims.

Reclassifications

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

2. NET PATIENT SERVICE REVENUE

The System has agreements with third-party payors that provide for reimbursement to the System at amounts different from its established rates. Estimated contractual adjustments under third-party reimbursement programs represent the difference between the System's billings at standard rates and amounts reimbursed by third-party payors. They also include any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. A summary of the reimbursement arrangements with major third-party payors is as follows:

Medicare

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment Hospital). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment. The System's classification of patients under the Prospective Payment Hospital and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization which is under contract with the System to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Medicaid

The System is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.

The System is eligible for the Indiana Medicaid Supplemental programs including Medicaid Disproportionate Share Hospital and Municipal Upper Payment Limit programs. The System recognized reimbursement from these programs within net patient revenue of approximately \$1,687,000 and \$9,333,000 during 2008 and 2007, respectively. These programs are Federal programs administered by the state.

Other Payors

The System also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the System 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 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Inpatient routine services	\$ 41,114,772	\$ 40,274,624
Inpatient ancillary services	79,613,878	78,064,765
Outpatient ancillary services	<u>209,615,887</u>	<u>201,684,595</u>
Gross patient service revenue	330,344,537	320,023,984
Contractual allowance	170,117,330	154,498,014
Charity care	8,199,155	6,827,073
Bad debts	9,859,435	9,190,107
Deductions from revenue	<u>188,175,920</u>	<u>170,515,194</u>
Net patient service revenue	<u>\$ 142,168,617</u>	<u>\$ 149,508,790</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

3. CHARITY CARE

The System 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. Charity care provided was \$8,199,155 and \$6,827,073 for 2008 and 2007, respectively.

4. INVESTMENTS

Investments are recorded at fair value and consist of the following as of December 31:

	2008	2007
Cash and cash equivalents	\$ 695,812	\$ 529,471
Mutual funds - equity	7,605,163	12,148,170
Mutual funds - fixed income	7,373,792	8,593,391
	<u>\$ 15,674,767</u>	<u>\$ 21,271,032</u>

5. ASSETS WHOSE USE IS LIMITED

The classification of assets whose use is limited includes:

Internally designated - Amounts transferred by the System's Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the System buildings as authorized by IC 16-22-3-13.

Funds held by trustee - System funds deposited with a trustee and limited as to use in accordance with the requirements of a trust indenture for debt service and capital construction.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. The composition of assets limited as to use includes the following as of December 31:

	<u>2008</u>	<u>2007</u>
Internally designated		
Cash and cash equivalents	\$ 397,778	\$ 30,112
Mutual funds - equity	2,781,751	4,968,801
Mutual funds - fixed income	<u>3,229,522</u>	<u>3,473,882</u>
	6,409,051	8,472,795
Held by trustee		
Cash and cash equivalents	<u>1,902,142</u>	<u>6,513,975</u>
Total assets whose use is limited	<u>\$ 8,311,193</u>	<u>\$ 14,986,770</u>

6. 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. Funded depreciation investments consist of cash equivalents and mutual funds.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

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

December 31, 2008

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Mutual funds - equity	\$ 10,386,914	\$ 10,386,914	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	10,603,314	10,603,314	-0-	-0-	-0-
	<u>\$ 20,990,228</u>	<u>\$ 20,990,228</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

December 31, 2007

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Mutual funds - equity	\$ 17,116,971	\$ 17,116,971	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	12,067,273	12,067,273	-0-	-0-	-0-
	<u>\$ 29,184,244</u>	<u>\$ 29,184,244</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

Interest rate risk – The System 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 System 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 System maintains its investments, which at times may exceed federally insured limits. The System has not experienced any losses in such accounts. The System believes that it is not exposed to any significant credit risk on investments.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Deposits and investments consist of the following as of December 31:

	<u>2008</u>	<u>2007</u>
Carrying amount		
Deposits	\$ 14,933,101	\$ 18,227,299
Mutual funds - equity	10,386,914	17,116,971
Mutual funds - fixed income	10,603,314	12,067,273
	<u>\$ 35,923,329</u>	<u>\$ 47,411,543</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 11,937,369	\$ 11,153,741
Investments	15,674,767	21,271,032
Internally designated	6,409,051	8,472,795
Held by trustee	1,902,142	6,513,975
	<u>\$ 35,923,329</u>	<u>\$ 47,411,543</u>

7. 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 System impacted by this pronouncement include the System's investments and assets whose use is limited which are measured using quoted prices in active markets and other significant other observable inputs.

The System 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.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

When fully adopted, the System 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 System 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 statement of financial position 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 that the System has the ability to access. Investments include mutual funds and corporate equity securities.

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 corporate and municipal bonds that trade infrequently and privately held 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. These investments could be certain private equity investments.

Based upon the levels as defined above the System's investments as of December 31, 2008 are classified as follows:

	Fair value measurements at reporting date using:			
	Total	Quoted market prices for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3
Mutual funds - equity	\$ 10,386,914	\$ 10,386,914	\$ -0-	\$ -0-
Mutual funds - fixed income	\$ 10,603,314	\$ 10,603,314	\$ -0-	\$ -0-

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

8. CAPITAL ASSETS

A summary of capital assets includes the following as of December 31:

	December 31, 2007	Additions	Retirements	Transfers	December 31, 2008
Land	\$ 644,187	\$ -0-	\$ -0-	\$ 358,691	\$ 1,002,878
Land improvements	3,199,230	126,134	(215,667)	3,357,989	6,467,686
Buildings and improvements	79,933,943	870,763	(475,941)	13,327,093	93,655,858
Equipment	50,954,946	2,684,720	(3,752,573)	13,607,369	63,494,462
Construction in progress	16,903,544	6,575,345	(181,860)	(19,073,656)	4,223,373
Total capital assets	<u>151,635,850</u>	<u>10,256,962</u>	<u>(4,626,041)</u>	<u>11,577,486</u>	<u>168,844,257</u>
Less accumulated depreciation					
Land improvements	1,242,579	418,832	(214,709)	-0-	1,446,702
Buildings and improvements	34,676,881	3,340,589	(448,259)	275,459	37,844,670
Equipment	30,785,183	5,917,228	(2,284,752)	5,816,618	40,234,277
Total accumulated depreciation	<u>66,704,643</u>	<u>9,676,649</u>	<u>(2,947,720)</u>	<u>6,092,077</u>	<u>79,525,649</u>
Capital assets, net	<u>\$ 84,931,207</u>	<u>\$ 580,313</u>	<u>\$ (1,678,321)</u>	<u>\$ 5,485,409</u>	<u>\$ 89,318,608</u>

	December 31, 2006	Additions	Retirements	Transfers	December 31, 2007
Land	\$ 644,187	\$ -0-	\$ -0-	\$ -0-	\$ 644,187
Land improvements	2,295,002	334,223	(6,540)	576,545	3,199,230
Buildings and improvements	69,384,756	325,066	(33,305)	10,257,426	79,933,943
Equipment	43,642,488	3,152,655	(2,482,587)	6,642,390	50,954,946
Construction in progress	16,075,668	18,390,433	(86,196)	(17,476,361)	16,903,544
Total capital assets	<u>132,042,101</u>	<u>22,202,377</u>	<u>(2,608,628)</u>	<u>-0-</u>	<u>151,635,850</u>
Less accumulated depreciation					
Land improvements	1,045,261	203,122	(5,804)	-0-	1,242,579
Buildings and improvements	31,840,283	2,867,639	(31,041)	-0-	34,676,881
Equipment	28,848,816	4,363,444	(2,427,077)	-0-	30,785,183
Total accumulated depreciation	<u>61,734,360</u>	<u>7,434,205</u>	<u>(2,463,922)</u>	<u>-0-</u>	<u>66,704,643</u>
Capital assets, net	<u>\$ 70,307,741</u>	<u>\$ 14,768,172</u>	<u>\$ (144,706)</u>	<u>\$ -0-</u>	<u>\$ 84,931,207</u>

9. LONG TERM DEBT

The System has the following bond issues outstanding with the Indiana Health Facility Financing Authority (IHFFA) and other local financial institutions as of December 31, 2008 and 2007:

- 1997 IHFFA Revenue Bonds, original issue \$6,800,000, paid off during 2007.
- 2005 IHFFA Revenue Bonds, original issue \$50,000,000, due through January 2035, variable interest rate of 4.10% as of December 31, 2008, secured by letters of credit in the amounts of approximately \$49,000,000 expiring through August 2010.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

- 2006 IHFFA Revenue Bonds, original issue \$1,875,766, due through January 2013, was retired in 2008 and replaced with a loan payable with a local financial institution with a variable interest rate of 5.15% as of December 31, 2008, secured by property.
- Loans payable with local financial institutions, due through 2026 at fixed and variable interest rates ranging from 1.5% to 6.63% as of December 31, 2008, secured by certain System assets.
- During 2008 the Imaging Center became a wholly owned subsidiary of the System. The Imaging Center has capital lease obligations with interest approximating 6.8% executed for property and equipment are due in monthly installments of varying amounts from \$19,518 to \$28,557 including interest, due through December 31, 2009. The total cost of the property and equipment under capital leases approximated \$5,600,000 as of December 31, 2008 and 2007 and is listed as security for the obligations. The associated accumulated depreciation approximated \$5,000,000 and \$4,500,000 as of December 31, 2008 and 2007, respectively.

A summary of long term debt for 2008 and 2007 follows:

	December 31, 2007	Transfers/ Borrowings	Payments	December 31, 2008	Current Portion
Revenue bonds					
2005 IHFFA Bonds	\$ 49,695,000	\$ -0-	\$ (800,000)	\$ 48,895,000	\$ 820,000
2006 IHFFA Bonds	1,325,838	-0-	(1,325,838)	-0-	-0-
Total revenue bonds	51,020,838	-0-	(2,125,838)	48,895,000	820,000
Loans payable	11,756,879	3,516,046	(767,991)	14,504,934	1,042,995
Capital lease obligations	-0-	2,479,936	(1,788,416)	691,520	691,520
Total long term debt	<u>\$ 62,777,717</u>	<u>\$ 5,995,982</u>	<u>\$ (4,682,245)</u>	<u>\$ 64,091,454</u>	<u>\$ 2,554,515</u>

	December 31, 2006	Transfers/ Borrowings	Payments	December 31, 2007	Current Portion
Revenue bonds					
1997 IHFFA Bonds	\$ 600,000	\$ -0-	\$ (600,000)	\$ -0-	\$ -0-
2005 IHFFA Bonds	50,000,000	-0-	(305,000)	49,695,000	800,000
2006 IHFFA Bonds	1,535,710	-0-	(209,872)	1,325,838	225,044
Total revenue bonds	52,135,710	-0-	(1,114,872)	51,020,838	1,025,044
Loans payable	12,187,742	-0-	(430,863)	11,756,879	394,015
Total long term debt	<u>\$ 64,323,452</u>	<u>-0-</u>	<u>\$ (1,545,735)</u>	<u>\$ 62,777,717</u>	<u>\$ 1,419,059</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Maturities for the years subsequent to December 31, 2008 are as follows:

Years Ending December 31,	Principal	Interest	Total
2009	\$ 2,554,515	\$ 2,404,375	\$ 4,958,890
2010	1,853,506	2,403,696	4,257,202
2011	1,934,639	2,333,894	4,268,533
2012	2,018,834	2,260,160	4,278,994
2013	1,865,013	2,197,702	4,062,715
2014-2018	8,746,114	9,895,033	18,641,147
2019-2023	10,531,843	7,817,820	18,349,663
2024-2028	12,496,990	5,341,517	17,838,507
2029-2033	15,205,000	2,909,813	18,114,813
2034-2035	6,885,000	377,738	7,262,738
	<u>\$ 64,091,454</u>	<u>\$ 37,941,748</u>	<u>\$ 102,033,202</u>

The bonds require the System to maintain certain financial ratios and restrictive covenants. As of December 31, 2008, the System was not in compliance with the financial ratios and covenants. The System obtained waivers for the covenant violations for December 31, 2008.

The System has construction contract commitments of approximately \$2 million and \$6 million outstanding as of December 31, 2008 and 2007, respectively.

The System has available letters of credit totaling approximately \$50,000,000 with financial institutions for the Series 2005 bonds. The letters of credit are intended to provide credit enhancement and liquidity support for the System's tax-exempt bonds. Advances bear interest at 10% annually. The letters of credit are collateralized by the Hospital's gross revenues as well as designated assets. The letters of credit expire on August 31, 2010. There was no balance outstanding as of December 31, 2008 and 2007. In the event of liquidity drawing the System will reimburse the bank in installments through the termination date unless the bonds are remarketed, redeemed or purchased at which time the liquidity advance is due. Reimbursements of other than liquidity drawings are due on the date such drawings are honored.

Subsequent to December 31, 2008, the letters of credit were amended.

The System has an interest rate swap agreement related to the 2005 Revenue Bonds.

The System has lines of credit with local financial institutions. The lines bear interest at rates ranging from a fixed rate of 5% to a variable rate of prime less .25% and expire on demand. There were no borrowings outstanding on the lines of credit as of December 31, 2008 and 2007.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

10. DERIVATIVE LIABILITY

In 2005, the System entered into two "cash flow hedge interest rate swap" agreements with a financial institution. The System pays a fixed interest rate (3.55% as of December 31, 2008 and 2007) and the financial institution pays a variable interest rate (1.9% and 3.51% as of December 31, 2008 and 2007, respectively) over the term of the agreements.

The System's objective is to provide protection against market driven increases in variable interest rates. The fair value of each agreement was determined by the financial institution using the present value of the estimated projected cash flows. The System is in a liability position as of December 31, 2008 and 2007 due to the present value of its estimated projected cash flows being greater than the financial institution's present value of estimated projected cash flows.

The first swap was effective on October 3, 2005 and matures on January 1, 2035. It contains an outstanding notional amount of \$30,000,000 with a 3.55% fixed rate of interest and is a derivative liability for the System with a fair value as of December 31, 2008 and 2007 of \$6,390,523 and \$646,787, respectively.

The second swap was effective on October 3, 2005 and matures on January 1, 2035. It contains an outstanding notional amount of \$10,000,000 with a 3.55% fixed rate of interest and is a derivative liability for the System with a fair value as of December 31, 2008 and 2007 of \$2,131,597 and \$215,565, respectively.

The unrealized loss on derivatives was \$7,659,767 and \$1,132,195 for 2008 and 2007, respectively. The liability is only payable upon termination of the agreements by the System. The liability is in other long term liabilities on the consolidated balance sheets.

11. PENSION PLAN

The System has a defined contribution pension plan as authorized by IC 16-22-3-11. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The plan was established by written agreement between the System's Board of Trustees and the plan administrator. The plan administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan. Contact the System's human resource department for information on the plan

Total pension expense for 2008 and 2007 was \$2,413,215 and \$3,459,922, respectively. The current employer contribution rate is 6% of annual covered payroll. The employer contribution rate for 2007 was 8% of annual covered payroll.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

12. COMMITMENTS AND CONTINGENCIES

Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. Leases expire through 2012. Total rental expense in 2008 and 2007 for all operating leases was \$4,508,242 and \$3,643,868, respectively.

Minimum payments under operating lease agreements for the years subsequent to December 31, 2008 are as follows:

<u>Years Ending December 31,</u>	
2009	\$ 1,529,691
2010	843,556
2011	677,304
2012	252,036
	<u>\$ 3,302,587</u>

13. CONCENTRATIONS

The System 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 as of December 31, 2008 and 2007 was as follows:

	<u>2008</u>	<u>2007</u>
Medicare	28%	34%
Medicaid	11%	11%
Blue Cross	17%	14%
Other third party payors	14%	14%
Self-pay	30%	27%
	<u>100%</u>	<u>100%</u>

The blended component units of the System maintain cash in accounts, which at times may exceed federally insured limits. The blended component units have not experienced any losses in such accounts. The blended component units believe that it is not exposed to any significant credit risk on cash and cash equivalents.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

14. INVESTMENTS IN AFFILIATED COMPANIES

North Central Indiana Linen Service, Inc.

The System owns 33% of North Central Indiana Linen Service. The investment is accounted for under the equity method. Summarized financial information as of December 31 follows:

	2008	2007
Assets	\$ 1,121,117	\$ 1,115,995
Liabilities	\$ 164,572	\$ 261,392
Equity	\$ 956,545	\$ 854,603
Revenue	\$ 1,560,461	\$ 1,608,894
Expenses	\$ 1,458,519	\$ 1,480,977
Net income	\$ 101,942	\$ 127,917

Kokomo LTACH, LLC

In December 2007, the System invested \$210,000 for 35% ownership in Kokomo LTACH, LLC to operate a long-term acute care hospital in Kokomo, Indiana. There was no financial activity for Kokomo LTACH, LLC in 2008 and 2007 other than the capitalization of the entity. Subsequent to December 31, 2008, Kokomo LTACH, LLC was dissolved.

15. PHYSICIAN RELOCATION AGREEMENTS AND OTHER MINIMUM REVENUE GUARANTEES

Consistent with the System's policy on physician relocation and recruitment, the System provides income guarantee agreements to certain physicians who agree to relocate to the community to fill a need in the System's service area and commit to remain in practice there. Under such agreements, the System is required to make payments to the physicians in excess of the amounts they earn in their practice up to the amount of the income guarantee. The income guarantee periods are typically one to three years. Such payments are recoverable from the physicians if they do not fulfill their commitment period to the community, which is typically three years. The System also provides minimum revenue collection guarantees to System-based physician groups providing certain services at the System with terms ranging from one to three years. As of December 31, 2008, the maximum potential amount of future payments under these guarantees was approximately \$250,000.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

In accordance with FASB Staff Position FIN 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners," as of December 31, 2008 and 2007, the System recorded a liability of approximately \$-0- and \$122,000, respectively, for the fair value of new or modified guarantees entered into with an offsetting asset recorded in other assets on the accompanying balance sheet, which will be amortized over the commitment period.

16. SELF FUNDED HEALTH INSURANCE

The System is self funded for medical and related health benefits provided to employees and their families. A stop/loss policy through commercial insurance covers individual claims in excess of \$100,000 per year. Provisions are made for unexpected and unusual claims.

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. Self funded health insurance and related expenses were \$6,728,334 and \$6,407,823 in 2008 and 2007, respectively. A progression of unpaid claims for 2008 and 2007 follows:

	<u>2008</u>	<u>2007</u>
Unpaid claims, beginning of year	\$ 1,162,889	\$ 1,300,742
Incurred claims and changes in estimates	6,728,334	6,407,823
Claim payments	<u>(6,835,905)</u>	<u>(6,545,676)</u>
Unpaid claims, end of year	<u>\$ 1,055,318</u>	<u>\$ 1,162,889</u>

SUPPLEMENTARY INFORMATION

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2008

ASSETS

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
Current assets								
Cash and cash equivalents	\$ 8,474,642	\$ 1,025,376	\$ 1,280,111	\$ 93,326	\$ 1,063,743	\$ 171	\$ -0-	\$ 11,937,369
Investments	13,851,390	1,823,377	-0-	-0-	-0-	-0-	-0-	15,674,767
Patient accounts receivable, net	19,575,388	-0-	1,338,089	-0-	-0-	218,632	-0-	21,132,109
Other receivables	3,213,723	41,067	14,860	14,010	1,414,453	5,329	(1,646,600)	3,056,842
Inventory and other current assets	5,162,377	-0-	213,445	-0-	347,089	32,709	-0-	5,755,620
Estimated third party settlements	122,728	-0-	-0-	-0-	-0-	-0-	-0-	122,728
Current portion of assets whose use is limited	820,000	-0-	-0-	-0-	-0-	-0-	-0-	820,000
Total current assets	<u>51,220,248</u>	<u>2,889,820</u>	<u>2,846,505</u>	<u>107,336</u>	<u>2,825,285</u>	<u>256,841</u>	<u>(1,646,600)</u>	<u>58,499,435</u>
Assets whose use is limited								
Internally designated	6,409,051	-0-	-0-	-0-	-0-	-0-	-0-	6,409,051
Held by trustee	1,835,033	67,109	-0-	-0-	-0-	-0-	-0-	1,902,142
Total assets whose use is limited	<u>8,244,084</u>	<u>67,109</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>8,311,193</u>
Less current portion of assets whose use is limited	820,000	-0-	-0-	-0-	-0-	-0-	-0-	820,000
Noncurrent portion of assets whose use is limited	<u>7,424,084</u>	<u>67,109</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>7,491,193</u>
Capital assets, net	84,056,906	289	645,562	705,483	535,333	3,375,035	-0-	89,318,608
Other assets	4,814,872	1,239,564	798,146	-0-	-0-	-0-	(4,465,426)	2,387,156
Total assets	<u>\$ 147,516,110</u>	<u>\$ 4,196,782</u>	<u>\$ 4,290,213</u>	<u>\$ 812,819</u>	<u>\$ 3,360,618</u>	<u>\$ 3,631,876</u>	<u>\$ (6,112,026)</u>	<u>\$ 157,696,392</u>

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2008

LIABILITIES AND NET ASSETS

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
Current liabilities								
Accounts payable and accrued expenses	\$ 3,734,279	\$ -0-	\$ 429,208	\$ 1,065,826	\$ 621,566	\$ 120,278	\$ (1,502,532)	\$ 4,468,625
Accrued liabilities	9,476,453	-0-	719,250	-0-	-0-	77,763	-0-	10,273,466
Other current liabilities	1,380,319	174,100	129,789	99,518	-0-	47,151	(205,773)	1,625,104
Current portion of loans payable	417,241	241,312	-0-	-0-	-0-	384,442	-0-	1,042,995
Current portion of capital lease payable	273,312	-0-	-0-	-0-	-0-	659,520	(241,312)	691,520
Current portion of revenue bonds payable	820,000	-0-	-0-	-0-	-0-	-0-	-0-	820,000
Total current liabilities	16,101,604	415,412	1,278,247	1,165,344	621,566	1,289,154	(1,949,617)	18,921,710
Long term debt								
Loans payable	11,019,717	869,493	-0-	37,000	-0-	1,572,729	(37,000)	13,461,939
Capital lease payable	867,547	-0-	-0-	-0-	-0-	-0-	(867,547)	-0-
Revenue bonds payable	48,075,000	-0-	-0-	-0-	-0-	-0-	-0-	48,075,000
Total long term debt	59,962,264	869,493	-0-	37,000	-0-	1,572,729	(904,547)	61,536,939
Other long term liabilities								
Total liabilities	84,585,988	1,284,905	1,278,247	1,202,344	621,566	2,861,883	(2,854,164)	86,980,769
Minority interest	-0-	-0-	-0-	-0-	-0-	-0-	2,590,109	2,590,109
Net assets								
Invested in capital assets, net of related debt	24,419,122	(1,110,516)	645,562	668,483	535,333	758,344	1,145,859	27,062,187
Restricted								
For debt service	1,835,033	67,109	-0-	-0-	-0-	-0-	-0-	1,902,142
Expendable for capital improvements	6,409,051	-0-	-0-	-0-	-0-	-0-	-0-	6,409,051
Expendable for other specific purposes	10,885	-0-	-0-	-0-	-0-	-0-	-0-	10,885
Held by Foundation	-0-	2,911,877	-0-	-0-	-0-	-0-	-0-	2,911,877
Total restricted net assets	8,254,969	2,978,986	-0-	-0-	-0-	-0-	-0-	11,233,955
Unrestricted	30,256,031	1,043,407	2,366,404	(1,058,008)	2,203,719	11,649	(6,993,830)	27,829,372
Total net assets	62,930,122	2,911,877	3,011,966	(389,525)	2,739,052	769,993	(5,847,971)	66,125,514
Total liabilities and net assets	\$ 147,516,110	\$ 4,196,782	\$ 4,290,213	\$ 812,819	\$ 3,360,618	\$ 3,631,876	\$ (6,112,026)	\$ 157,696,392

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2008

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
Revenues								
Net patient service revenue	\$ 117,095,201	\$ -	\$ 13,832,235	\$ -	\$ 10,156,164	\$ 2,955,869	\$ (1,870,852)	\$ 142,168,617
Other	13,171,939	228,386	924,453	486,520	394,677	1,815	(1,058,229)	14,149,561
Total revenues	<u>130,267,140</u>	<u>228,386</u>	<u>14,756,688</u>	<u>486,520</u>	<u>10,550,841</u>	<u>2,957,684</u>	<u>(2,929,081)</u>	<u>156,318,178</u>
Operating expenses								
Salaries and wages	56,993,876	-	7,388,390	-	2,991,495	775,511	-	68,149,272
Employee benefits	12,830,903	-	1,853,493	-	-	53,107	-	14,737,503
Medical professional fees	3,426,464	-	583,034	23,662	-	483,355	-	4,516,515
Medical supplies and drugs	25,300,927	-	930,059	32,204	2,453,869	207,764	-	28,924,823
Purchased services	9,311,093	-	842,512	466,519	500,820	152,963	(2,105,080)	9,168,827
Equipment rentals	6,635,393	-	1,168,442	29,186	1,024,854	705,409	(1,051,170)	8,512,114
Utilities and telephone	2,504,673	-	345,276	44,260	63,511	95,216	-	3,052,936
Insurance	1,055,928	-	63,485	12,146	38,218	49,132	-	1,218,909
Depreciation and amortization	8,350,220	-	212,493	77,913	197,764	906,035	-	9,744,425
Other	9,319,072	-	251,925	64,478	324,322	115,711	-	10,075,508
Total expenses	<u>135,728,549</u>	<u>-</u>	<u>13,639,109</u>	<u>750,368</u>	<u>7,594,653</u>	<u>3,544,203</u>	<u>(3,156,250)</u>	<u>158,100,832</u>
Operating income (loss)	(5,461,409)	228,386	1,117,579	(263,848)	2,955,988	(586,519)	227,169	(1,782,654)
Nonoperating revenues (expenses)								
Investment income	(6,351,677)	(743,505)	-	1,395	54,795	9,528	-	(7,029,464)
Interest expense	(2,880,319)	-	-	(375)	-	(235,478)	(227,169)	(3,343,341)
Unrealized loss on derivatives	(7,659,767)	-	-	-	-	-	-	(7,659,767)
Other nonoperating revenues (expenses)	274,649	(106,789)	(4,215)	(29,278)	-	(337,244)	(531,709)	(734,586)
Nonoperating revenues (expenses), net	<u>(16,617,114)</u>	<u>(850,294)</u>	<u>(4,215)</u>	<u>(28,258)</u>	<u>54,795</u>	<u>(563,194)</u>	<u>(758,878)</u>	<u>(18,767,158)</u>
Excess (deficit) of revenues over expenses before minority interest	(22,078,523)	(621,908)	1,113,364	(292,106)	3,010,783	(1,149,713)	(531,709)	(20,549,812)
Minority interest	-	-	-	-	-	-	(1,867,104)	(1,867,104)
Excess (deficit) of revenues over expenses after minority interest	<u>(22,078,523)</u>	<u>(621,908)</u>	<u>1,113,364</u>	<u>(292,106)</u>	<u>3,010,783</u>	<u>(1,149,713)</u>	<u>(2,398,813)</u>	<u>(22,416,916)</u>
Other changes in net assets								
Member contributions	-	-	-	152,085	-	-	(152,085)	-
Member distributions	-	-	(1,000,000)	-	(4,280,999)	-	5,280,999	-
Other changes in net assets	-	-	(1,000,000)	152,085	(4,280,999)	-	5,128,914	-
Change in net assets	<u>(22,078,523)</u>	<u>(621,908)</u>	<u>113,364</u>	<u>(140,021)</u>	<u>(1,270,216)</u>	<u>(1,149,713)</u>	<u>2,730,101</u>	<u>(22,416,916)</u>
Net assets								
Beginning of year	85,008,645	3,533,785	2,898,602	(249,504)	4,009,258	1,919,706	(8,578,072)	88,542,430
End of year	<u>\$ 62,930,122</u>	<u>\$ 2,911,877</u>	<u>\$ 3,011,966</u>	<u>\$ (389,525)</u>	<u>\$ 2,739,052</u>	<u>\$ 769,993</u>	<u>\$ (5,847,971)</u>	<u>\$ 66,125,514</u>

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2007

ASSETS

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Eliminations	Total
Current assets							
Cash and cash equivalents	\$ 7,372,348	\$ 611,033	\$ 1,024,026	\$ 67,164	\$ 2,079,170	\$ -0-	\$ 11,153,741
Investments	18,292,726	2,978,306	-0-	-0-	-0-	-0-	21,271,032
Patient accounts receivable, net	21,804,564	-0-	1,432,377	-0-	-0-	-0-	23,236,941
Other receivables	2,690,056	-0-	-0-	35,136	1,719,788	(1,464,233)	2,980,747
Inventory and other current assets	4,899,627	-0-	206,223	-0-	265,991	-0-	5,371,841
Estimated third party settlements	5,997,457	-0-	-0-	-0-	-0-	-0-	5,997,457
Current portion of assets whose use is limited	800,000	-0-	-0-	-0-	-0-	-0-	800,000
Total current assets	61,856,778	3,589,339	2,662,626	102,300	4,064,949	(1,464,233)	70,811,759
Assets whose use is limited							
Internally designated	8,472,795	-0-	-0-	-0-	-0-	-0-	8,472,795
Held by trustee	6,417,577	96,398	-0-	-0-	-0-	-0-	6,513,975
Total assets whose use is limited	14,890,372	96,398	-0-	-0-	-0-	-0-	14,986,770
Less current portion of assets whose use is limited	800,000	-0-	-0-	-0-	-0-	-0-	800,000
Noncurrent portion of assets whose use is limited	14,090,372	96,398	-0-	-0-	-0-	-0-	14,186,770
Capital assets, net	83,144,746	391	532,560	723,995	529,515	-0-	84,931,207
Other assets	7,142,967	1,482,536	865,922	-0-	-0-	(4,987,226)	4,504,199
Total assets	\$ 166,234,863	\$ 5,168,664	\$ 4,061,108	\$ 826,295	\$ 4,594,464	\$ (6,451,459)	\$ 174,433,935

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2007

LIABILITIES AND NET ASSETS

	Howard	HRHS	Howard	Kokomo	Howard	Eliminations	Total
	Regional Health System	Foundation	Regional Specialty Care	Sports Center	Community Surgery Center		
Current liabilities							
Accounts payable and accrued expenses	\$ 5,882,606	\$ -0-	\$ 447,323	\$ 936,252	\$ 585,196	\$ (1,374,993)	\$ 6,476,384
Accrued liabilities and other	9,752,873	-0-	622,775	-0-	-0-	-0-	10,375,648
Other current liabilities	1,763,248	309,041	92,408	102,547	-0-	(143,392)	2,123,852
Current portion of loans payable	394,015	-0-	-0-	-0-	-0-	-0-	394,015
Current portion of capital lease payable	225,044	-0-	-0-	-0-	-0-	(225,044)	-0-
Current portion of revenue bonds payable	800,000	225,044	-0-	-0-	-0-	-0-	1,025,044
Total current liabilities	18,817,786	534,085	1,162,506	1,038,799	585,196	(1,743,429)	20,394,943
Long term debt							
Loans payable	11,428,411	-0-	-0-	37,000	-0-	(102,547)	11,362,864
Capital lease payable	1,100,794	-0-	-0-	-0-	-0-	(1,100,794)	-0-
Revenue bonds payable	48,895,000	1,100,794	-0-	-0-	-0-	-0-	49,995,794
Total long term debt	61,424,205	1,100,794	-0-	37,000	-0-	(1,203,341)	61,358,658
Other long term liabilities							
Total liabilities	81,226,218	1,634,879	1,162,506	1,075,799	585,196	(2,946,770)	82,737,828
Minority interest	-0-	-0-	-0-	-0-	-0-	3,153,677	3,153,677
Net assets							
Invested in capital assets, net of related debt	26,719,059	(1,325,447)	532,560	686,995	529,515	1,428,385	28,571,067
Restricted							
For debt service	6,417,577	96,398	-0-	-0-	-0-	-0-	6,513,975
Expendable for capital improvements	8,472,795	-0-	-0-	-0-	-0-	-0-	8,472,795
Expendable for other specific purposes	12,440	-0-	-0-	-0-	-0-	-0-	12,440
Held by Foundation	-0-	3,533,785	-0-	-0-	-0-	-0-	3,533,785
Total restricted net assets	14,902,812	3,630,183	-0-	-0-	-0-	-0-	18,532,995
Unrestricted	43,386,774	1,229,049	2,366,042	(936,499)	3,479,753	(8,086,751)	41,438,368
Total net assets	85,008,645	3,533,785	2,898,602	(249,504)	4,009,268	(6,658,366)	88,542,430
Total liabilities and net assets	\$ 166,234,863	\$ 5,168,664	\$ 4,061,108	\$ 826,295	\$ 4,594,464	\$ (6,451,459)	\$ 174,433,935

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2007

	Howard Regional Health System	HIRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Eliminations	Total
Revenues							
Net patient service revenue	\$ 125,318,164	\$ -0-	\$ 13,333,620	\$ -0-	\$ 10,857,006	\$ -0-	\$ 149,508,790
Other	13,929,662	41,216	658,817	438,427	-0-	(1,245,405)	13,822,717
Total revenues	<u>139,247,826</u>	<u>41,216</u>	<u>13,992,437</u>	<u>438,427</u>	<u>10,857,006</u>	<u>(1,245,405)</u>	<u>163,331,507</u>
Operating expenses							
Salaries and wages	56,606,612	-0-	6,833,513	-0-	2,520,175	-0-	65,960,300
Employee benefits	13,588,575	-0-	1,714,026	-0-	-0-	-0-	15,302,601
Medical professional fees	4,698,023	-0-	726,692	20,113	-0-	-0-	5,444,828
Medical supplies and drugs	27,960,071	-0-	936,288	35,542	2,772,782	-0-	31,704,683
Purchased services	8,174,794	-0-	1,104,238	513,092	508,418	(182,799)	10,117,743
Equipment rentals	5,899,198	-0-	1,173,918	38,383	1,067,598	(1,024,100)	7,154,997
Utilities and telephone	2,280,793	-0-	376,321	45,407	28,114	-0-	2,730,635
Insurance	958,243	-0-	64,737	12,383	37,802	-0-	1,073,165
Depreciation and amortization	7,007,766	-0-	205,540	85,223	186,359	-0-	7,484,888
Other	10,031,274	-0-	211,306	61,664	349,574	-0-	10,653,818
Total expenses	<u>137,205,349</u>	<u>-0-</u>	<u>13,346,579</u>	<u>811,807</u>	<u>7,470,822</u>	<u>(1,206,899)</u>	<u>157,627,658</u>
Operating income (loss)	<u>2,042,477</u>	<u>41,216</u>	<u>645,858</u>	<u>(373,380)</u>	<u>3,386,184</u>	<u>(38,506)</u>	<u>5,703,849</u>
Nonoperating revenues (expenses)							
Investment income	2,402,792	235,747	-0-	377	85,634	-0-	2,724,550
Interest expense	(2,120,595)	-0-	-0-	-0-	-0-	38,506	(2,082,089)
Unrealized loss on derivatives	(1,132,195)	-0-	-0-	-0-	-0-	-0-	(1,132,195)
Other nonoperating revenues (expenses)	1,718,853	(177,978)	(927)	-0-	-0-	(1,927,183)	(387,235)
Nonoperating revenues (expenses), net	<u>868,855</u>	<u>57,769</u>	<u>(927)</u>	<u>377</u>	<u>85,634</u>	<u>(1,888,677)</u>	<u>(876,969)</u>
Excess (deficit) of revenues over expenses before minority interest	2,911,332	98,985	644,931	(373,003)	3,471,818	(1,927,183)	4,826,880
Minority interest	-0-	-0-	-0-	-0-	-0-	(1,816,563)	(1,816,563)
Excess (deficit) of revenues over expenses after minority interest	<u>2,911,332</u>	<u>98,985</u>	<u>644,931</u>	<u>(373,003)</u>	<u>3,471,818</u>	<u>(3,743,746)</u>	<u>3,010,317</u>
Other changes in net assets							
Member contributions	-0-	-0-	2,687,404	80,879	-0-	(2,768,283)	-0-
Member distributions	-0-	-0-	-0-	-0-	(2,919,114)	2,919,114	-0-
Other changes in net assets	-0-	-0-	2,687,404	80,879	(2,919,114)	150,831	-0-
Change in net assets	<u>2,911,332</u>	<u>98,985</u>	<u>3,332,335</u>	<u>(292,124)</u>	<u>552,704</u>	<u>(3,592,915)</u>	<u>3,010,317</u>
Net assets							
Beginning of year	82,097,313	3,434,800	(433,733)	42,620	3,456,564	(3,065,451)	85,532,113
End of year	<u>\$ 85,008,645</u>	<u>\$ 3,533,785</u>	<u>\$ 2,898,602</u>	<u>\$ (249,504)</u>	<u>\$ 4,009,268</u>	<u>\$ (6,658,366)</u>	<u>\$ 88,542,430</u>

See report of independent auditors on pages 1 and 2.