union

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AUGUST 31, 2008 AND 2007

CPAs / ADVISORS

blue

UNION HOSPITAL INC. AND SUBSIDIARIES

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AUGUST 31, 2008 AND 2007

CPAS / ADVISORS

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REPORT OF INDEPENDENT AUDITORS

Board of Directors
Union Hospital
Terre Haute, Indiana

We have audited the accompanying consolidated balance sheet of Union Hospital, Inc. and Subsidiary (the Corporation) as of August 31, 2008, and the related consolidated statements of operations, changes in net assets and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The August 31, 2007 consolidated financial statements of Union Hospital, Inc. and Subsidiary were audited by other auditors whose report dated December 28, 2007, expressed an unqualified opinion on those consolidated statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 audit provides a reasonable basis for our opinion.

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

Our audit was performed for the purpose of expressing an opinion on the consolidated financial statements taken as a whole. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audit and in our opinion, is fairly stated, in all material respects in relation to the consolidated financial statements taken as a whole.

Blue & Co., LLC

November 13, 2008

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AUGUST 31, 2008 AND 2007

LIABILITIES AND NET ASSETS

	2008	2007 Restated
Current liabilities		
Accounts payable and other current liabilities	$ 26,833,665	$ 24,382,037
Salaries, wages and related liabilities	15,061,366	15,333,581
Accrued interest	5,828,316	2,171,494
Current portion of long-term debt	4,343,979	9,126,813
Total current liabilities	52,067,326	51,013,925
Long-term liabilities		
Long-term debt, less current portion	261,182,527	261,905,554
Deferred revenue	3,270,842	3,592,686
Accrued pension cost	20,429,882	9,699,706
Total long-term liabilities	284,883,251	275,197,946
Total liabilities	336,950,577	326,211,871
Net assets		
Unrestricted	110,548,049	105,900,808
Temporarily restricted	7,020,226	4,956,847
Permanently restricted	1,010,484	1,017,113
Total net assets	118,578,759	111,874,768
Total liabilities and net assets	$ 455,529,336	$ 438,086,639

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED AUGUST 31, 2008 AND 2007

	2008	2007 Restated
Operating revenue		
Net patient service revenue including charity care of $27,304,098 and $18,977,685, respectively	$ 361,422,065	$ 335,880,709
Other revenue	11,245,857	9,010,157
Total operating revenue	372,667,922	344,890,866
Operating expenses		
Salaries and wages	106,854,705	100,703,385
Employee benefits	29,048,010	25,573,608
Supplies and drugs	48,019,754	55,221,164
Physician services	9,029,788	8,413,633
Contract services	102,504,734	76,692,953
Rent and leases	10,377,763	8,507,235
Utilities, supplies, and other	18,138,984	16,784,341
Provision for bad debts	23,469,833	28,321,396
Depreciation and amortization	11,392,028	10,688,488
Interest	2,479,389	3,110,436
Total operating expenses	361,314,988	334,016,639
Income from operations	11,352,934	10,874,227
Nonoperating gains		
Investment income	3,793,316	3,074,873
Other	(180,455)	(196,747)
Total nonoperating revenues	3,612,861	2,878,126
Net income	14,965,795	13,752,353
Other changes in unrestricted net assets		
Effect of adoption of recognition provisions of FAS 158	(10,730,176)	(8,022,157)
Net unrealized gain (loss) on investments	(22,539)	381,464
Net assets released for property and equipment	462,117	287,583
Other changes in unrestricted net assets	(27,956)	536,329
Change in unrestricted net assets	4,647,241	6,935,572
Temporarily restricted net assets		
Contributions and other	2,525,496	104,353
Net assets released for property and equipment	(462,117)	(287,583)
Change in temporarily restricted net assets	2,063,379	(183,230)
Permanently restricted net assets		
Net investment income	(6,629)	58,562
Change in net assets	6,703,991	6,810,904
Net assets		
Beginning of year	111,874,768	105,063,864
End of year	$ 118,578,759	$ 111,874,768

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

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

	2008	2007 (Restated)
Operating activities		
Change in net assets	$ 6,703,991	$ 6,810,904
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	10,861,786	10,221,486
Amortization	530,242	467,002
Change in pension liability	-0-	17,779
Provision for bad debts	23,469,833	28,321,396
Net loss on property disposals	280,453	204,123
Restricted contributions, net	(2,056,750)	124,668
Net unrealized (gain)/loss on investments	22,539	(381,464)
Change in minimum pension liability and adoption of recognition provisions of FAS 158	10,730,176	8,022,157
Changes in operating assets and liabilities		
Patient accounts receivable	(28,523,130)	(43,134,908)
Other current and noncurrent assets	(1,635,044)	(3,863,132)
Accounts payable and other current liabilities	2,451,628	15,012,791
Salaries, wages and related liabilities	(272,215)	(2,148,716)
Estimated third-party payor settlements	(1,042,870)	135,441
Accrued interest	3,656,822	1,349,309
Deferred revenue	(321,844)	2,317,464
Net cash flows from operating activities	24,855,617	23,476,300
Investing activities		
Purchases of property and equipment	(59,450,068)	(40,417,160)
Change in trustee held investments	40,062,963	(151,370,272)
Change in board designated funds and other	(1,895,943)	(2,844,433)
Net cash flows from investing activities	(21,283,048)	(194,631,865)
Financing activities		
Net borrowings/repayments on line of credit	(5,647,568)	4,709,903
Issuance of long-term debt	-0-	178,644,869
Bond issuance costs	-0-	(2,151,525)
Repayments on long-term debt	(3,725,512)	(3,616,469)
Restricted contributions, net	2,056,750	(124,668)
Net cash flows from financing activities	(7,316,330)	177,462,110
Change in cash and cash equivalents	(3,743,761)	6,306,545
Cash and cash equivalents		
Beginning of year	32,632,766	26,326,221
End of year	$ 28,889,005	$ 32,632,766

See accompanying notes to consolidated financial statements.

1. ORGANIZATION

Nature of Operations

Union Hospital, Inc. (Corporation) is an Indiana nonprofit corporation which owns and operates Union Hospital (the Hospital), a 280 staffed-bed, regional referral center hospital located in Terre Haute, Indiana. The Hospital is a full-service, acute-care hospital with medical-surgical, obstetric, pediatric, coronary care, post-coronary care, intensive care, maximum care, and medical rehabilitation units. Additionally, as the largest hospital in west central Indiana, the Hospital is a referral center for such services as its newborn intensive care unit (Level II), open heart surgery, cardiac rehabilitation clinic, radiology, cardiopulmonary services, and radiation therapy. The Hospital and its related consolidated entity provide comprehensive health care services to the residents of Terre Haute and the surrounding communities, west central Indiana, and east central Illinois through its acute and specialty care facilities and physician medical practices. Union Hospital, Inc. is exempt from federal income taxes on related function income pursuant to Section 501(c) (3) and Section 501(a) of the Internal Revenue Code.

The consolidated financial statements include the accounts of the Hospital, West Central Community Hospital (WCCH), IPACS, Inc. (IPACS), and Ash Pharmacy of Indiana, Inc. (Ash) (collectively, the Corporation and subsidiary). WCCH, a designated Medicare critical access hospital, operates as a division of the Corporation and is a 25-bed general, acute care hospital located in Clinton, Indiana. IPACS is a wholly owned, taxable subsidiary engaged in providing collection services to hospitals, hospital physicians, and other health care providers. Ash is a taxable subsidiary of IPACS that provides durable medical equipment services to the Corporation's patients.

The Corporation is related to various organizations principally through overlapping board membership. These organizations include Union Hospital Foundation, Inc., Union Hospital Health Services, Inc., and Visiting Nurse Association of the Wabash Valley, Inc. These affiliated organizations are not included in the consolidated financial statements. In addition, a majority of all fund-raising activities are conducted by Union Hospital Foundation, Inc. (the Foundation). Accordingly, unrestricted gifts and bequests received directly by the Corporation are recorded as nonoperating gains, and restricted gifts and bequests received by the Foundation for the benefit of the Corporation are recorded by the Corporation as temporarily restricted net assets until expended by the Corporation for their intended purpose.

Charity Care and Community Benefit

Patients are provided care regardless of their ability to pay in accordance with charity care policies of the Corporation. These policies define charity care services as those services for which no or reduced payment is anticipated and are based on federal poverty income levels and certain other factors. Such amounts are not reported as revenue. Charity care provided by the Corporation in 2008 and 2007 measured at established rates amounted to $27,304,098 and $18,977,685, respectively. The Corporation's charity care policies also extend to services provided by physicians, although records are not maintained for such services provided by the physicians.

The Corporation also provides programs and services to address the needs of the communities it serves, generally at no, or low, cost to those being served. Specific community needs being addressed by the Corporation include, among others, low-weight births and infant mortality, high incidence of, and deaths from, certain diseases and chronic illnesses, underserved populations, adequacy of the supply of physicians and other health care providers, and certain behavioral risk factors. The Corporation's programs and services include, among others, services to low-income women in need of prenatal care, health screenings for underserved women, wellness and injury prevention programs, chronic disease management assistance, educational programs, rural health care access and availability initiatives, transportation services for elderly and low-income patients, and access to support groups for critically and chronically ill patients and their families. Assistance is also provided to senior citizens and other patients and their families for the submission of forms for insurance, financial counseling, and application to the Medicare and Medicaid programs for health service coverage. The Corporation periodically reviews, modifies, and reports on its Community Health Assessment and Plan of Action for the communities served.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from management's estimates.

Net Patient Service Revenue and Other

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

Medicare: Physician services, inpatient acute care services, and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Critical access hospital services are reimbursed based on cost reimbursement methodologies. Cost reimbursable services are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary.

Medicaid: Reimbursement for services rendered to Medicaid program beneficiaries are at prospectively determined rates per discharge for inpatient hospital services. Other services are reimbursed based on a combination of cost reimbursement methodologies and prospectively determined rates.

Other: Reimbursement for services to certain patients is received from commercial insurance carriers, health maintenance organizations, preferred provider organizations, and other payors, based on prospectively determined rates per discharge or discount of charges for inpatient hospital services and discount of charges for outpatient services.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimated settlements could change by a material amount in the near term. Management believes that adequate provisions have been made for any adjustments which may result from such final settlements. Changes in estimated allowances increased the excess of revenues over expenses by $1,724,000 in 2008 and $1,396,000 in 2007.

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets follows:

	2008	2007
Inpatient revenue	$ 395,924,101	$ 351,574,467
Outpatient revenue	443,955,409	368,969,284
Physician revenue	39,346,441	36,181,698
Gross patient revenue	879,225,951	756,725,449
Charity care revenue foregone	27,304,098	18,977,685
Contractual adjustments	490,499,788	401,867,055
Total adjustments	517,803,886	420,844,740
Net patient service revenue	$ 361,422,065	$ 335,880,709

A summary of patient service revenue at established rates by payor source is as follows:

	2008	2007
Medicare	47%	48%
Medicaid	13%	13%
Commercial insurance	4%	4%
Other managed care	28%	29%
Self-pay and other	8%	6%
	100%	100%

There is a single insurance provider that constituted 17% of patient service revenue at established rates for the years ended August 31, 2008 and 2007.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less when purchased, excluding investments limited as to use. The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximate fair value.

Patients Accounts Receivable, Estimated Third Party Settlements, and Net Patient Service Revenue

Patients accounts receivable and net patient service revenue are reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered. Net patient service revenue includes estimated retroactive adjustments under reimbursement agreements with certain third-party payors (principally for the Medicare program). Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, adjusted in future periods as final settlements are determined, and are included with estimated receivables from third-party payors.

The Corporation grants credit to patients, substantially all of whom are local residents of the communities served. The Corporation does not generally require credit or other collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). At August 31, 2008 and 2007, approximately 32% and 37%, respectively, of net accounts receivable was collectible from governmental payors (including Medicare and Medicaid).

The allowance for doubtful accounts receivable is based on management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy for uncollectible receivables based upon the payor composition and aging of receivables as of the reporting date with consideration of the historical write-off experience by payor category. The results of these reviews are then used to make any modifications to the provision for uncollectible receivables to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the Corporation follows established guidelines for placing past-due patient accounts with collection agencies.

Inventories

Inventories, consisting primarily of medical supplies and pharmaceuticals, are stated at the lower of cost or market and principally valued using the average cost method.

Investments Limited as to Use

Investments limited as to use are stated at fair value. The fair value of assets are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The cost of securities sold is based on the specific identification method. Dividends and interest income and realized gains and losses on sales of investments are recorded as nonoperating gains (losses). Unrealized appreciation and temporary depreciation (temporary losses) of investments are reported as other changes in net assets in the consolidated statements of operations and changes in net assets.

Investments are generally commingled for investment purposes and consist of short-term investments (principally money market mutual funds), U.S. government and governmental agency obligations, mutual and common trust funds, corporate obligations, marketable equity securities, and guaranteed investment contracts. Fair values for investments, with the exception of guaranteed investment contracts, are based on quoted market prices. Guaranteed investment contracts are valued at fair value as reported by the custodian.

Investments limited as to use include investments set aside by the Board of Directors for future capital improvements and retirement of debt over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes; investments held by trustees under bond indenture agreements; and donor-restricted funds. Amounts that are required for obligations classified as current liabilities, and other amounts previously paid from operating cash that are to be reimbursed by the applicable funds held by trustee project fund, are reported in current assets.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. The estimated useful lives are as follows: land improvements 3 to 30 years, buildings 5 to 40 years, and equipment 3 to 25 years. The Corporation's policy is to designate certain available unrestricted net assets for expansion and renovation.

Equipment under capital lease obligations is amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation and amortization in the consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction and other interest costs are capitalized as a component of the cost of constructing the assets. In addition, interest earnings on unexpended borrowed funds related to tax-exempt financings are also capitalized. Net interest costs capitalized amounted to $4,009,573 in 2008 and $804,668 in 2007. Repair and maintenance costs are expensed when incurred.

The Corporation periodically evaluates whether circumstances have occurred that would indicate whether the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of such assets may not be recoverable. When factors indicate that such assets should be evaluated for possible impairment, an estimate is made of the undiscounted cash flows over the remaining life of the assets in measuring whether the asset is recoverable in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*

Unamortized Debt Issuance Costs

Costs incurred in connection with the issuance of long-term debt are amortized using the bonds outstanding method, which approximates the amortization under the effective interest rate method, and are included in depreciation and amortization in the accompanying consolidated statements of operations and changes in net assets.

Medical Malpractice Insurance

The Corporation and its employed physicians with active Indiana medical licenses are qualified as health providers under the Indiana Medical Malpractice Act (the Medical Malpractice Act). The Medical Malpractice Act limits liability for malpractice claims against qualified health care providers such as the Corporation. The law provides for a mandatory State Patient's Compensation Fund (the Compensation Fund) to which qualified health care providers contribute a surcharge. The amount of the surcharge is established by the Indiana Department of Insurance on an actuarial basis. The amount contributed by each hospital must be sufficient to cover, but may not exceed, the actuarial risk posed to the Compensation Fund by such hospital and its employed physicians with active Indiana medical licenses. For malpractice incidents occurring after December 31, 1989, and before July 1, 1999, the Medical Malpractice Act provides for a maximum recovery of $750,000 per claim ($3,000,000 annual aggregate); the related health care provider is liable for up to $100,000 of the recovery. For malpractice incidents occurring on or after July 1, 1999, the Medical Malpractice Act provides for a maximum recovery of $1,250,000 per claim ($7,500,000 annual aggregate); the related health care provider is liable for up to $250,000 of the recovery.

Effective December 31, 2003, the Corporation became a member in a Vermont captive insurance company, Indiana Healthcare Reciprocal Risk Retention Group, Inc., to fund the Corporation's required portion of the insurance coverage pursuant to the Medical Malpractice Act, as well as its general liability insurance.

The Corporation also provides medical malpractice insurance for its employed physicians who practice in the state of Illinois with limits of $1,000,000 per occurrence and $3,000,000 in the aggregate.

Malpractice insurance coverage provided through the Compensation Fund and the captive insurance company is provided on a claims-made basis. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be uninsured.

Pension Plan

A noncontributory, defined-benefit pension plan covers substantially all employees. Plan benefits are based on years of service and the employee's compensation. Contributions to the plan include amortization of prior service costs plus interest thereon and are funded currently.

Financial Instruments

Financial instruments consist of cash and cash equivalents, patient accounts receivable, investments limited as to use, accounts payable and accrued liabilities, estimated receivables from and payables to third-party payors, and long-term debt. The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, patient accounts receivable, estimated receivables from and payables to third-party payors, and accounts payable and accrued liabilities approximate fair values. The fair values for investments limited as to use and long-term debt are described disclosed herein.

Net Assets

Temporarily restricted net assets are those assets whose use by the Corporation has been limited by donors primarily for a specified time period or purpose. When a donor restriction expires or is met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released for property and equipment. Temporarily restricted net assets include $7,020,226 and $4,956,847 of funds held by the Foundation for the benefit of the Corporation at August 31, 2008 and 2007, respectively and other restricted funds held by the Corporation. Due from Union Hospital, Inc. Foundation represents contributions received on behalf of the Corporation by the Foundation and other amounts the Foundation has granted to the Corporation. Permanently restricted net assets are those that the donor has requested to be held in perpetuity. In accordance with the donor stipulation certain investment income earned on permanently restricted net assets can be used for other than the donor-restricted purpose. Accordingly such income is recorded in the unrestricted net asset class as it is earned and expended.

Deferred Income

Deferred revenue represents amounts received in advance for services to be rendered. Revenue will be recognized as the services are provided.

Health Insurance

The Corporation's employee health care insurance is provided through a combination of self-insurance and purchased re-insurance coverage from a commercial carrier. The Corporation maintains an estimated liability for the amount of claims incurred but not reported. Substantially all employees are covered for major medical benefits.

Functional Expenses

The Corporation provides general health care services to patients. Health care services expenses related to providing these services were approximately $345,214,208 and $314,070,444 in 2008 and 2007, respectively. Administrative expenses (consisting of support services, employee benefits, patient billing, and other) amounted to $16,100,780 and $19,946,195 in 2008 and 2007, respectively.

Income Taxes

The Internal Revenue Service has determined that the Corporation and the majority of its affiliated entities are tax-exempt organizations as defined in Section 501(c)(3) of the Internal Revenue Code. Certain subsidiaries of the Corporation are taxable entities; the tax expense and liabilities of which are not material to the consolidated financial statements.

Operating Indicator

The Corporation's operating indicator (income from operations) includes all unrestricted net income, gains and support, and expenses from Corporation operations directly related to recurring and ongoing health care operations during the reporting period. The operating indicator excludes interest, dividend, and realized gains and losses on sales of investments, contributions, and gains and losses deemed by management not to be directly related to providing health care services.

Performance Indicator

The Corporation's performance indicator (net income) includes all changes in unrestricted net assets other than net unrealized appreciation and temporary losses on investments, investment returns restricted by donors, contributions of property and equipment, and adjustments required by the adoption of new Financial Accounting Standards Board (FASB) pronouncements.

Reclassifications

Certain amounts in the 2007 consolidated financial statements have been reclassified to conform to the 2008 presentation. These reclassifications had no impact on net assets for 2007, as previously reported.

3. RESTATEMENT

During 2008, management discovered an error resulting in an understatement of previously reported accrued pension as of August 31, 2006. Accordingly, an adjustment has been made to net assets to correct the error. The following is the restatement of net assets:

Net assets	
As previously reported, August 31, 2006	$ 106,741,413
Prior period adjustment - correction of error	(1,677,549)
As restated, August 31, 2006	$ 105,063,864

4. ACQUISITIONS AND AFFILIATIONS

During 1996, the Corporation entered into a sublease and operating agreement and a related management services agreement (collectively, the Sublease Agreement) with WCCH (formerly Vermillion County Hospital). In December 2005, the Corporation purchased the remaining assets of WCCH consisting of land and the West Central Community Hospital building for $4,821,353, of which $2,373,935 was paid at closing. A five-year, noninterest-bearing note with monthly payments of $41,667 was entered into and is included in long-term debt in the Corporation's balance sheets. At August 31, 2008 and 2007 the remaining balance is $1,083,322 and $1,583,326, respectively.

On December 29, 2006, the shares of Ash, a for-profit durable medical equipment company, were transferred from its wholly owned parent, Union Hospital Foundation, Inc., to IPACS.

During 2008 the Board of Directors approved to discontinue the operation of ASH pharmacy once all remaining accounts receivable were collected or deemed uncollectible.

The Corporation has collaborated with physicians and physician groups to improve quality of services, eliminate duplication of services, improve standards of care and outsourcing the cost of operations by entering into contractual agreements in fiscal 2007. The Corporation has these agreements for chemotherapy, ambulatory surgery, cardiac catheterization laboratory, and radiation oncology therapy services. The Hospital pays a fee to the physician and/or physician group for each unit of service pursuant to these agreements, and bills and collects from the patients and third-party payors for the services provided as departments of the Hospital in order to outsource the operations. The costs for these services are included in contracted services in the income statement totaling $82,547,602 and $57,001,742 for August 31, 2008 and 2007, respectively.

5. PROPERTY AND EQUIPMENT

A summary of the construction-in-progress projects at August 31, 2008, is as follows:

New Hospital	$ 50,677,174
EPSI	140,000
Other renovations and upgrades	114,406
	$ 50,931,580

The Corporation has entered into a contract with a construction company to serve as both the construction manager and general contractor to build a new 500,000 square-foot building to include a 236-bed facility featuring all private rooms, fully integrated wireless technology, and additional parking, as well as to provide certain renovations to the existing Hospital facility. Certain services currently provided in the existing Hospital facility will be relocated to the new facility. Construction-in-progress is anticipated to extend through early calendar 2010. Commitments for all remaining construction project costs total $109,500,000 at August 31, 2008. As of August 31, 2008 the project is approximately 31% complete.

6. INVESTMENTS

The Corporation does not engage in trading activities for investment purposes. The composition of investments, at fair value, is set forth in the following table:

	2008	2007
Cash and short-term investments	$ 17,575,958	$ 12,537,594
US Government and government agency obligations	7,259,100	11,105,387
Mutual and common trust funds	1,193,918	2,507,175
Corporate obligations	2,092,085	403,927
Marketable equity securities	7,137,141	6,931,807
Guaranteed investment contracts	135,900,313	175,862,184
	171,158,515	209,348,074
Less current portion	15,733,560	11,663,760
	$ 155,424,955	$ 197,684,314

Investment income included in the consolidated statements of operations and changes in net assets is primarily comprised of interest income.

At August 31, 2008, the Corporation held $3,250,225 of securities in a gross unrealized loss position totaling $510,598. At August 31, 2007, the Corporation held $4,145,721 of securities in an unrealized loss position totaling $245,564.

In June 1995, the Corporation entered into a contract to receive the present value of expected earnings on certain required trustee-held funds in exchange for actual investment earnings. Approximately $2,000,000 was deposited into trustee-held funds and is being amortized to income over the period of the agreement, which expires in 2015. $702,270 remains unamortized at August 31, 2008.

7. LONG-TERM DEBT

Obligated Group

A Master Trust Indenture, as amended, provides for the issuance of long-term debt under an obligated group structure. The Obligated Group currently consists of Union Hospital, Inc. and does not anticipate any other entities will become members of the Obligated Group. This Obligated Group is required to meet certain covenants under the Master Trust Indenture. The Obligated Group is subject to certain financial performance covenants, among other compliance requirements, that require the maintenance of debt service ratios. As of August 31, 2008, management of the Obligated Group believes that it is in compliance with all financial covenants.

Issuance of Debt

During July 2007, the Hospital issued, through the Hospital Authority of Vigo County (Indiana), Hospital Revenue Bonds, Series 2007 (tax-exempt bonds) in the aggregate amount of $176.5 million principally to finance, or reimburse the Corporation for, the costs of acquisition, construction, furnishing, and equipping of a new 500,000 square-foot hospital building, and certain renovations of the existing hospital facility, bond issuance cost, debt service reserve fund, and capitalized interest during the construction period. The interest rate is fixed and ranges from 5.50% to 5.80%. Term bonds expire in 2027 ($7.4 million), 2037 ($52.2 million), 2042 ($50.3 million), and 2047 ($66.6 million) with principle payments beginning in 2024.

Long-term debt is summarized as follows:

	2008	2007
Indiana Health and Educational Facility Financing Authority or Hospital Authority of Vigo County (Indiana):		
Series 2007, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2024 through 2048. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 5.50% to 5.80% and averages 5.75%.	$ 176,068,549	$ 176,054,771
Series 2006A, tax-exempt variable rate demand revenue bonds payable in annual principle installments commencing in fiscal 2009 through fiscal 2037. Interest rate is set weekly (payable semiannually) and averaged 2.66% in fiscal 2008.	19,000,000	19,000,000
Series 2006B, taxable variable rate demand revenue bonds, payable in annual principle installments commencing in fiscal 2009 through fiscal 2037. Interest rate is set weekly (payable semiannually) and averaged 4.08% in fiscal 2008.	13,000,000	13,000,000
Series 2002, tax-exempt variable rate demand revenue bonds, payable in annual principle installments commencing in fiscal 2004 through fiscal 2028. Interest rate set weekly (payable semiannually) and averaged 2.70% in fiscal year 2008.	13,915,000	14,365,000
Series 2004, adjustable rate taxable securities payable in annual principle installments commencing in fiscal 2006 through fiscal 2026. Interest in fiscal year 2008 (payable monthly) is based on LIBOR's seven-day floating rate and averaged 4.11%.	7,220,000	7,490,000
Series 1993, tax-exempt serial and term bonds, payable in annual principle installments commencing in fiscal 1996 through fiscal 2024. Interest (payable semiannually) ranges from 5.125% to 5.250%. Series 1993 is subject to a swap transaction, with interest rate set weekly at BMA plus 40 basis points (payable semiannually) and averaged 3.10% in fiscal 2008.	29,370,000	30,620,000
Line of credit	-0-	5,647,568
Capital leases and other	6,952,957	4,855,028
Total long-term debt	265,526,506	271,032,367
Less current portion	4,343,979	9,126,813
Long-term debt, less current portion	$ 261,182,527	$ 261,905,554

The scheduled maturities and mandatory redemptions of long-term debt are as follows:

Year	
2009	$ 4,343,979
2010	4,469,518
2011	3,895,553
2012	3,584,076
2013	3,224,831
Thereafter	246,008,549
	$ 265,526,506

In February 2004, the Corporation made a tender offer to existing 1993 Bondholders for a 103% tender price, which was accepted. A bank purchased the tendered bonds for par value. Simultaneously, the Corporation and the bank entered into a Total Return Swap Agreement (the swap), the purpose of which was to synthetically convert the tendered bonds from a fixed rate to a short-term, variable rate based on the Bond Market Association Municipal Swap Index plus .40%. The variable rate at August 31, 2008, was 2.22%. The swap is in place throughout the terms of the outstanding bonds, but may be terminated by the Corporation or the bank with 30 and 60 days notice, respectively. Neither the terms nor conditions of the original bonds were altered in any way. Should the swap be terminated, the swap provides that the Corporation is required to pay the bank a cash amount equal to the positive difference between the initial market price of the terminated bonds (100 at February 5, 2004) and the market price at termination (estimated to be $0 at August 31, 2008 and 2007).

The Corporation issued $8,000,000 in adjustable rate taxable securities in October 2004. The proceeds of the 2004 Bonds were used to pay the taxable portion of costs associated to capital projects.

In May 2002, the Corporation issued $16,000,000 of tax-exempt, variable rate, demand revenue bonds (the Series 2002 Bonds), using the Master Indentures and through the Indiana Health Facility Financing Authority. The proceeds of the Series 2002 Bonds and certain other funds of the Corporation were used to finance or reimburse certain costs of constructing, acquiring, renovating, or equipping certain health facility property.

The Series 1993 tax-exempt Bonds are secured by a security interest in unrestricted receivables (as defined in the bond agreements) of the Corporation. The bond agreements also require maintenance of certain debt service income ratios, limit additional borrowings, require the maintenance of certain trustee-held funds, and require compliance with various other restrictive covenants. Payment of principle and interest on the Series 1993 Bonds is guaranteed under a municipal bond insurance policy.

During May 2002, the Corporation opened a letter of credit for a maximum of $16,000,000 attached to the Series 2002 Bonds to cover noncompliance with principle and interest payments. There were no draws on the letter during fiscal year 2008 and 2007, and there are no outstanding amounts under this arrangement at August 31, 2008 and 2007. The letter of credit was extended in 2006 and expires July 13, 2011.

The Corporation also opened a letter of credit for a maximum of $13,000,000 attached to the Series 2006B taxable Bonds to cover noncompliance with principle and interest payments. There were no draws on the letter during fiscal year 2008 and 2007, and there are no outstanding amounts under this arrangement at August 31, 2008 and 2007. The letter of credit expires July 13, 2011.

In July 2006, the Corporation opened a letter of credit for a maximum of $19,000,000 attached to the Series 2006A tax-exempt Bonds to cover noncompliance with principle and interest payments. There were no draws on the letter during fiscal year 2008 and 2007, and there are no outstanding amounts under this arrangement at August 31, 2008 and 2007. The letter of credit expires July 13, 2011.

In October 2004, the Corporation opened a letter of credit for a maximum of $8,000,000 attached to the Series 2004 taxable Bonds to cover noncompliance with principle and interest payments. There were no draws on the letter during fiscal year 2008 and 2007, and there are no outstanding amounts under this arrangement at August 31, 2008 and 2007. The letter of credit expires on October 31, 2009.

The fair value of the 2007 fixed rate tax exempt bonds approximated $269,600,000 as of August 31, 2008. The fair value of the fixed rate obligations is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of variable rate debt (Series 1993, 2004, 2002, 2006A and 2006B) approximates its carrying value.

Total interest paid on long-term debt for the years ended August 31, 2008 and 2007, aggregated approximately $3,400,000 and $2,700,000 respectively.

In January 2005, the Corporation opened a three-year line of credit for a maximum of $15,000,000. In fiscal 2007, the Corporation renegotiated the terms of the line of credit. The line was subsequently changed to a short-term note expiring in January 2008. The outstanding amount of $5,647,568 existing at August 31, 2007 was paid off during the current year.

The Corporation leases medical equipment and software under capital leases with various expiration dates. Cost and accumulated depreciation of the equipment under capital leases was approximately $7,412,000 and $2,282,000, respectively, at August 31, 2008, and $4,770,392 and $1,446,934, respectively, at August 31, 2007.

During 2008 and 2007 the Corporation entered into new capital leases in the approximate amount of $3,867,000 and $1,987,000, respectively.

The following is a schedule by year of future minimum lease payments under capital leases as of August 31, 2008, that have initial or remaining lease terms in excess of one year.

Year	
2009	$ 2,123,403
2010	1,669,237
2011	1,409,952
2012	982,658
2013	466,349
	6,651,599
Less imputed interest	781,964
Present value of minimum lease payments	$ 5,869,635

The Corporation has operating leases for medical equipment and office space. Total rent and lease expense for 2008 and 2007 was $10,377,763 and $8,507,235, respectively. Future minimum lease payments under noncancelable operating leases as of August 31, 2008 that have initial or remaining lease terms in excess of one year are as follows:

Year	
2009	$ 7,304,311
2010	5,008,840
2011	3,974,514
2012	2,861,428
2013	1,299,103
Thereafter	928,746
	$ 21,376,942

8. PENSION PLAN

The Corporation has a noncontributory, defined-benefit plan (the Plan) covering substantially all of its employees who are at least 21 years old and have completed one year of service, and certain employees meeting those requirements of affiliated organizations. The Plan provides for retirement, survivor, and severance benefits. Employees with five or more years of service are entitled to monthly pension benefits beginning at normal retirement age (65) equal to their credited service multiplied by 1/60th of 1% of the total of their annual compensation for the five consecutive plan years which produce the highest total. The Corporation has agreed to contribute such amounts as are necessary to provide assets sufficient to meet the benefits to be paid to plan members. Contributions include normal cost, interest on unfunded prior service cost, and amortization of prior service cost over a period not exceeding 30 years. The Plan has met the minimum funding requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

As discussed in Note 3, the Corporation adopted SFAS No. 158 as it relates to recognizing the funded status of its defined-benefit pension plan in its consolidated balance sheets and related disclosures. Funded status is defined as the difference between the projected benefit obligation and the fair value of plan assets. Upon addition, the Corporation recorded an adjustment to unrestricted net assets representing the recognition of previously unrecorded pension liabilities related to net unrecognized actuarial losses, unrecognized prior service costs, and unrecognized prior service credits. These amounts will be subsequently recognized as a component of net periodic pension cost pursuant to the Corporation's historical accounting policy for recognizing such amounts.

The incremental effect of the adoption of SFAS 158 was to recognize accrued pension cost of $8,022,157 on the Corporations accompanying balance sheet as of August 31, 2007. The adoption of SFAS No. 158 had no effect on the Corporations excess of revenue and gains over expenses for the year ended August 31, 2007, or for any period, and it will not affect the Corporations operating results in future periods.

Prior unrecognized net actuarial losses of $10,730,176 and $8,022,157 have been included in the unrestricted net assets at August 31, 2008 and 2007, respectively and have not yet been recognized in net periodic pension cost.

Actuarial losses included in unrestricted net assets at August 31, 2008, and expected to be amortized in net periodic benefit cost during fiscal 2009 are $977,885.

The following table sets forth the defined-benefit pension plan's benefit obligations, fair value of the Plan's assets, and funded status at August 31, 2008 and 2007:

	2008	2007
Change in benefit obligation		
Benefit obligation, beginning of year	$ 73,856,934	$ 67,398,764
Service cost	3,673,962	3,441,832
Interest cost	4,986,466	4,550,315
Benefits paid	(1,626,477)	(1,632,082)
Actuarial (gain) loss	733,167	98,105
Benefit obligation, end of year	$ 81,624,052	$ 73,856,934
Changes in plan assets		
Fair value of plan assets, beginning of year	$ 64,157,228	$ 55,775,177
Actual return on plan assets	(5,314,581)	6,078,133
Employer contributions	3,978,000	3,936,000
Benefits paid	(1,626,477)	(1,632,082)
Fair value of plan assets, end of year	$ 61,194,170	$ 64,157,228
Funded status		
Funded status of the plan, end of year	$ (20,429,882)	$ (9,699,706)

No plan assets are expected to be returned to the Corporation during the fiscal year ended August 31, 2008.

The following is a summary of the components of net periodic pension costs:

	2008	2007
Components of net periodic benefit cost		
Service cost	$ 3,673,962	$ 3,441,832
Interest cost	4,986,466	4,550,315
Expected return on plan assets	(4,898,189)	(4,271,019)
Amortization	48,959	232,651
Net periodic benefit cost	$ 3,811,198	$ 3,953,779

The following is a schedule, by year, of expected benefit payments, which reflect expected future service:

Year Ending August 31,	
2009	$ 2,040,827
2010	2,222,458
2011	2,473,935
2012	2,805,286
2013	3,089,397
2014-2018	21,654,616
	$ 34,286,519

The weighted-average assumptions used to determine the Plan's projected benefit obligation and net periodic benefit costs for the years ended August 31, 2008 and 2007 are as follows:

	2008	2007
Discount rate	6.5%	6.5%
Expected return on plan assets	7.5%	7.5%
Rate of compensation increase	5.0%	5.0%

The principal long-term determinant of a portfolio's investment return is its asset allocation. The Plan's allocation includes growth assets (65%) and fixed income (35%) investments. In addition, active management strategies have added value relative to passive benchmark returns. The expected long-term rate of return assumption is based on the mix of assets in the Plan, the long-term earnings expected to be associated with each asset class, and the additional return expected through active management.

The Plan's weighted-average asset allocations at August 31, 2008 and 2007, by asset category, are as follows:

	2008	2007
Mutual funds - equity funds	65%	66%
Mutual funds - bond funds	31%	30%
Alternative investments	0%	1%
Other	4%	3%
	100%	100%

The Plan employs an investment advisor to monitor the Plan's investment managers and make investment recommendations to the Corporation. The Corporation invests fund balances in a structured portfolio of equity and bond mutual funds and alternative investments. The target allocation strategy for the Plan is to have its investment portfolio comprise approximately 60% to 70% growth investments, 25% to 32% fixed-income investments, and 0% to 8% in alternative investments. Within the growth investment classification, the Plan's asset strategy encompasses equity and equity-like instruments that are expected to represent approximately 60.0% of the Corporation's plan asset portfolio of both public and private market investments. The largest component of these equity and equity-like instruments is public equity securities that are well diversified and invested in U.S. and international companies.

Projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category.

The Corporation expects to contribute approximately $4,296,000 to the pension plan in 2009 and will meet the required funding amounts for 2008.

9. RELATED PARTY TRANSACTIONS

The Corporation provided management and other services and paid amounts on behalf of the Foundation and other related organizations approximating $1,749,681 in 2008 and $1,407,173 in 2007. At August 31, 2008 and 2007, $352,142 and $256,114, respectively, remained unpaid.

The Corporation received $2,447,756 in donations from the Foundation in fiscal 2008, $462,117 of which was for the donation of equipment and credited to the Corporation's unrestricted net assets. In fiscal 2007, the Corporation received $621,809 in donations from the Foundation, $287,583 of which was for the donation of equipment and credited to the Corporation's unrestricted net assets.

10 . COMMITMENTS AND CONTINGENCIES

The Corporation is involved in litigation arising in the normal course of business. After consultation with legal counsel, it is management's opinion that these matters will be resolved without a material adverse effect on the Corporation's financial position or consolidated results of operations and changes in net assets.

11. SUBSEQUENT EVENT

During October 2008, management received a notice of demand of collateral after the fair value of the 1993 Bonds fell below par value. Approximately $5,250,000 of US Treasury and agency securities were transferred from board designated funds to a restricted account held to serve as collateral.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AUGUST 31, 2008 AND 2007

ASSETS

	2008	2007 Restated
Current assets		
Cash and cash equivalents	$ 28,889,005	$ 32,632,766
Funds held by trustee, current portion	15,733,560	11,663,760
Patient accounts receivable, net of allowance for bad debt of $6,697,015 and $7,021,458 for August 31, 2008 and 2007, respectively	52,579,403	47,526,106
Other receivables	116,151	93,242
Estimated third party settlements	1,397,752	354,882
Inventories	4,140,634	4,212,415
Prepaid expenses and other current assets	5,202,366	7,537,777
Total current assets	108,058,871	104,020,948
Investments limited as to use, less current portion		
Funds held by trustee	132,807,066	176,939,829
Board designated funds	21,607,405	19,727,372
Permanently restricted	1,010,484	1,017,113
Total investments limited as to use	155,424,955	197,684,314
Property and equipment		
Land and improvements	26,148,879	21,983,976
Buildings and fixed equipment	144,745,980	114,310,981
Movable equipment	85,540,851	79,900,346
	256,435,710	216,195,303
Less allowances for depreciation	130,298,689	125,894,859
	126,137,021	90,300,444
Construction in progress	50,931,580	34,593,109
Total property and equipment, net	177,068,601	124,893,553
Other assets		
Due from Union Hospital Foundation, Inc.	7,020,226	4,956,847
Notes receivable	4,004,793	3,017,207
Deferred financing costs	2,751,278	2,782,565
Other assets	1,200,612	731,205
	14,976,909	11,487,824
Total assets	$ 455,529,336	$ 438,086,639

See accompanying notes to consolidated financial statements.