



UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AUGUST 31, 2010 AND 2009

CPAs / ADVISORS



UNION HOSPITAL INC. AND SUBSIDIARIES

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Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

REPORT OF INDEPENDENT AUDITORS

Board of Directors
Union Hospital
Terre Haute, Indiana

We have audited the accompanying consolidated balance sheets of Union Hospital, Inc. and Subsidiary (the Corporation) as of August 31, 2010 and 2009, and the related consolidated statements of operations, changes in net assets and cash flows for the years 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 audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Corporation as of August 31, 2010 and 2009 and the consolidated results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 1 to the consolidated financial statements, during 2010, the Corporation became part of an affiliated group of entities and has entered into transactions with the group members.

Board of Directors
Union Hospital
Terre Haute, Indiana

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 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Blue & Co., LLC

November 17, 2010

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AUGUST 31, 2010 AND 2009

ASSETS	2010	2009
Current assets		
Cash and cash equivalents	\$ 21,860,231	\$ 34,666,639
Funds held by trustee, current portion	7,999,514	13,349,216
Board designated, current portion	11,594,606	7,880,784
Patient accounts receivable, net	49,874,670	55,114,141
Other receivables	155,041	200,652
Estimated third party settlements	2,449,523	811,568
Inventories	5,049,617	3,896,518
Prepaid expenses and other current assets	3,672,239	4,910,242
Total current assets	102,655,441	120,829,760
Investments limited as to use, less current portion		
Funds held by trustee	20,891,627	45,433,373
Board designated funds	15,828,556	12,583,003
Permanently restricted	946,496	969,067
Total investments limited as to use	37,666,679	58,985,443
Property and equipment		
Land and improvements	34,992,891	27,471,920
Buildings and fixed equipment	302,031,737	147,646,662
Movable equipment	108,121,126	91,140,189
	445,145,754	266,258,771
Less allowances for depreciation	149,879,627	142,154,071
	295,266,127	124,104,700
Construction in progress	3,817,467	145,514,284
Total property and equipment, net	299,083,594	269,618,984
Other assets		
Due from Union Hospital Foundation, Inc.	6,883,219	9,636,804
Notes receivable	-	2,845,094
Deferred financing costs	2,431,096	2,587,667
Intangible assets, net	6,120,840	-
Other assets	565,208	566,004
	16,000,363	15,635,569
Total assets	\$ 455,406,077	\$ 465,069,756

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AUGUST 31, 2010 AND 2009

LIABILITIES AND NET ASSETS

	<u>2010</u>	<u>2009</u>
Current liabilities		
Accounts payable and other current liabilities	\$ 22,456,572	\$ 23,475,766
Salaries, wages and related liabilities	15,759,874	14,877,731
Accrued interest	5,769,510	5,794,628
Current portion of long-term debt	5,727,439	5,061,554
Total current liabilities	<u>49,713,395</u>	<u>49,209,679</u>
Long-term liabilities		
Long-term debt, less current portion	255,089,318	257,201,155
Deferred revenue	507,720	2,896,156
Pension liability	14,462,593	28,170,741
Total long-term liabilities	<u>270,059,631</u>	<u>288,268,052</u>
Total liabilities	319,773,026	337,477,731
Net assets		
Unrestricted	127,903,141	117,085,733
Temporarily restricted	6,783,414	9,537,225
Permanently restricted	946,496	969,067
Total net assets	<u>135,633,051</u>	<u>127,592,025</u>
Total liabilities and net assets	<u>\$ 455,406,077</u>	<u>\$ 465,069,756</u>

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS AUGUST 31, 2010 AND 2009

	2010	2009
Operating revenue		
Net patient service revenue net of charity care of \$29,411,015 and \$33,754,936, respectively	\$ 393,953,085	\$ 395,024,175
Other revenue	9,035,371	9,759,037
Total operating revenue	402,988,456	404,783,212
Operating expenses		
Salaries and wages	119,920,067	113,097,407
Employee benefits	30,965,206	30,546,224
Supplies and drugs	69,144,157	52,989,952
Physician services	9,055,805	8,776,175
Contract services	69,460,073	102,400,976
Rent and leases	11,653,240	10,007,395
Utilities, supplies, and other	31,606,519	29,705,388
Provision for bad debts	30,784,528	28,669,700
Depreciation and amortization	21,932,655	14,196,773
Interest	8,513,504	2,679,833
Total operating expenses	403,035,754	393,069,823
Income from operations	(47,298)	11,713,389
Nonoperating gains (losses)		
Investment income	720,679	2,177,028
Other	(176,728)	431,588
Total nonoperating gains (losses)	543,951	2,608,616
Net income	496,653	14,322,005
Other changes in unrestricted net assets		
Pension related changes other than net periodic pension cost	11,086,274	(7,740,859)
Net unrealized gain (loss) on investments	318,439	(1,523,517)
Net assets released for property and equipment	3,176,042	1,485,707
Transfers to Union Health System	(4,260,000)	-0-
Other changes in unrestricted net assets	-0-	(5,652)
Change in unrestricted net assets	10,817,408	6,537,684
Temporarily restricted net assets		
Other changes in receivable from Union Hospital Foundation, Inc.	422,231	4,002,706
Net assets released for property and equipment	(3,176,042)	(1,485,707)
Change in temporarily restricted net assets	(2,753,811)	2,516,999
Permanently restricted net assets		
Net investment income	(22,571)	(41,417)
Change in net assets	8,041,026	9,013,266
Net assets		
Beginning of year	127,592,025	118,578,759
End of year	\$ 135,633,051	\$ 127,592,025

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED AUGUST 31, 2010 AND 2009

	2010	2009
Operating activities		
Change in net assets	\$ 8,041,026	\$ 9,013,266
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	20,223,971	13,668,932
Amortization	1,708,684	527,841
Provision for bad debts	30,784,528	28,669,700
Transfers to Union Health System	4,260,000	-0-
Net loss on property disposals	167,216	131,439
Other changes in receivable from Union Hospital Foundation, Inc.	(422,231)	(4,002,706)
Net unrealized (gain)/loss on investments	(216,245)	1,474,893
Pension related changes other than net periodic pension cost	(11,086,274)	7,740,859
Changes in operating assets and liabilities		
Patient accounts receivable	(25,545,057)	(31,204,438)
Other current and noncurrent assets	2,780,163	(770,892)
Accounts payable and other current liabilities	(1,019,194)	(3,357,899)
Salaries, wages and related liabilities	882,143	(183,635)
Estimated third-party payor settlements	(1,637,955)	586,184
Accrued interest	(25,118)	(33,688)
Deferred revenue	(2,388,436)	(374,686)
Net cash flows from operating activities	26,507,221	21,885,170
Investing activities		
Purchases of property and equipment	(45,348,626)	(105,389,666)
Proceeds from sale of equipment and land	20,627	589,237
Purchase of intangible asset	(7,345,000)	-0-
Change in trustee held investments	29,891,448	89,758,037
Change in board designated funds and other	(6,720,559)	(289,858)
Net cash flows from investing activities	(29,502,110)	(15,332,250)
Financing activities		
Repayments on long-term debt	(5,973,750)	(4,777,992)
Other changes in receivable from Union Hospital Foundation, Inc.	422,231	4,002,706
Transfers to Union Health System	(4,260,000)	-0-
Net cash flows from financing activities	(9,811,519)	(775,286)
Change in cash and cash equivalents	(12,806,408)	5,777,634
Cash and cash equivalents		
Beginning of year	34,666,639	28,889,005
End of year	\$ 21,860,231	\$ 34,666,639
Noncash investing activities		
Issuance of capital leases	\$ 4,527,798	\$ 1,528,393

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

1. ORGANIZATION

Nature of Operations

Union Hospital, Inc. (Corporation) is an Indiana not-for-profit corporation which owns and operates Union Hospital (the Hospital), a 318 staffed-beds, and 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 entities 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, Union Hospital Clinton (UHC), IPACS, Inc. (IPACS), and the Center for Occupational Health (COH) (collectively, the Corporation and subsidiaries). UHC is a designated Medicare critical access hospital operating as a division of the Corporation. UHC 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. COH provides work related injury care and other occupational medicine services. All material intercompany accounts and transactions have been eliminated.

During 2010, the Corporation became part of an affiliated group. Union Health System, Inc (UHS), a newly formed Indiana not-for-profit corporation, became the sole member of Union Associated Physicians Clinic, LLC (UAPc), a newly formed entity as well, and the Corporation. Certain physicians who were members or employees of AP&S, an existing outside and unrelated party (physician practice), became employees of UAPc. AP&S continues to provide certain personnel, equipment, supplies and other administrative support to UAPc. The Corporation has entered into transactions with the affiliated group as is disclosed in Note 3. The Corporation is consolidated into the affiliated group financial statements. These financial statements reflect only the financial position, results of operations, changes in net assets and cash flows of the Corporation.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

The Corporation is also related to various organizations principally through overlapping board membership which does not constitute control. These organizations include Union Hospital Foundation, Inc., Union Hospital Health Services, Inc., and Visiting Nurse Association of the Wabash Valley, Inc. 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 2010 and 2009 measured at established rates amounted to \$29,411,015 and \$33,754,936, 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.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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 \$653,000 in 2010 and \$441,000 in 2009.

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:

	<u>2010</u>	<u>2009</u>
Inpatient revenue	\$ 459,501,787	\$ 421,862,661
Outpatient revenue	515,932,206	513,745,238
Physician revenue	<u>39,104,914</u>	<u>42,171,540</u>
Gross patient revenue	1,014,538,907	977,779,439
Charity care revenue foregone	29,411,015	33,754,936
Contractual adjustments	<u>591,174,807</u>	<u>549,000,328</u>
Total adjustments	<u>620,585,822</u>	<u>582,755,264</u>
Net patient service revenue	<u>\$ 393,953,085</u>	<u>\$ 395,024,175</u>

A summary of gross patient service revenue at established rates by payor source for 2010 and 2009, respectively, is as follows:

	<u>2010</u>	<u>2009</u>
Medicare	48%	48%
Medicaid	14%	12%
Commercial insurance	3%	3%
Other managed care	26%	27%
Self-pay and other	9%	10%
	<u>100%</u>	<u>100%</u>

There is a single insurance provider that constituted 17% and 18% of patient service revenue at established rates for the years ended August 31, 2010 and 2009.

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.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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, 2010 and 2009, net accounts receivable from patients and third party were composed as follows:

	<u>2010</u>	<u>2009</u>
Medicare	29%	31%
Medicaid	7%	7%
Commercial insurance	5%	5%
Other managed care	37%	37%
Self-pay and other	22%	20%
	<u>100%</u>	<u>100%</u>

The allowance for doubtful accounts approximated \$16,600,000 for 2010 and 2009 and 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.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

Investments Limited as to Use

Investments limited as to use are stated at fair value. The fair value of assets is 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 \$3,400,000 in 2010 and \$6,700,000 in 2009. Repair and maintenance costs are expensed when incurred.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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 accounting standards.

Intangible Assets

Intangible assets are carried at cost. Amortization is computed using the straight-line method based on the assets' estimated useful lives.

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.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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 Plans

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. During 2010 the Corporation froze the defined benefit plan and initiated a discretionary match component to the 403b defined contribution plan.

Financial Instruments

Financial instruments consist of cash and cash equivalents, patient accounts receivable, notes receivable, due from Foundation, investments limited as to use, other assets, 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 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 \$6,883,219 and \$9,537,225 of funds held by the Foundation for the benefit of the Corporation at August 31, 2010 and 2009, respectively. 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 is unrestricted. Accordingly such income is recorded in the unrestricted net asset class as it is earned.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

Financial Statement Presentation

The Corporation is required to report information regarding its financial position and activities according to three classes of net assets (unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets) based upon the existence or absence of donor imposed restrictions.

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. The specific annual attachment point for an individual is \$300,000 with a life-time maximum of \$700,000.

Functional Expenses

The Corporation provides general health care services to patients. Health care services expenses related to providing these services were approximately \$381,306,674 and \$374,827,801 in 2010 and 2009, respectively. Administrative expenses (consisting of support services, employee benefits, patient billing, and other) amounted to \$21,808,532 and \$18,238,265 in 2010 and 2009, 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.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

Advertising Costs

Advertising costs are expensed as incurred. Total expense for 2010 and 2009 was \$638,688 and \$573,512, respectively.

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, changes in pension plan funded status, contributions of property and equipment, and equity transactions.

Derivatives

The Corporation uses derivatives to manage financial risks related to interest rate movements and the effects on its cash flows. The Corporation's derivative is an interest rate swap. The agreement is recorded at its fair value with subsequent changes in fair value, if any, included in the change in unrestricted net assets.

Subsequent Events

The Corporation has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued which is November 17, 2010.

Reclassifications

Certain amounts in the 2009 consolidated financial statements have been reclassified to conform to the 2010 presentation. These reclassifications had no impact on net assets for 2009, as previously reported.

3. AFFILIATED ENTITY AND RELATED PARTY TRANSACTIONS

As part of the current year affiliation with UHS and UAPc the Corporation purchased certain intangible assets, including medical records and other assets, from AP&S in the amount of \$7,345,000. The intangible assets are being amortized over 5 years with accumulated amortization of \$1,224,160 at August 31, 2010. The Corporation transferred \$4,260,000 during 2010 to UHS. The arrangement with UHS and UAPc contemplates that the Corporation will continue to transfer approximately \$1,000,000 dollars per month to UHS for on-going operational support to the affiliated group.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

The Corporation provided management and other services for the Foundation and other related organizations in the amount of \$976,436 in 2010 and \$1,008,179 in 2009. At August 31, 2010 and 2009, \$192,181 and \$148,507, respectively, remained unpaid.

The Corporation received approximately \$3,200,000 and \$1,500,000 in contributions from the Foundation for the years ended August 31, 2010 and 2009, respectively.

The Corporation collaborates with physicians and physician groups including UAPc, to improve the quality of services, eliminate duplication of services, and to improve standards of care by entering into certain contractual agreements. While certain of the agreements are amended and/or terminated from time to time the Corporation has had agreements for chemotherapy, ambulatory surgery, cardiac catheterization, laboratory, and radiation oncology therapy services. The costs for these services are included in contracted services in the statement of operations totaling \$48,366,855 and \$87,394,142 for August 31, 2010 and 2009, respectively.

4. PROPERTY AND EQUIPMENT

A summary of the construction-in-progress projects at August 31, 2010 and 2009 is as follows:

	2010	2009
New Hospital	\$ -0-	\$ 130,566,506
UH West renovation	2,628,346	-0-
Other renovations and upgrades	1,189,121	14,947,778
	<u>\$ 3,817,467</u>	<u>\$ 145,514,284</u>

The Corporation is in the process of renovating Union West facilities with no known completion date disclosed. In addition, the Corporation is expecting to finish the EMPI and Picaso software projects by December, 2010. Commitments for all remaining construction project costs total \$8,700,000 at August 31, 2010.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

5. 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:

	2010	2009
Cash and short-term investments	\$ 43,046,446	\$ 39,605,387
US Government and government agency obligations	6,598,035	6,260,408
Mutual funds	1,597,671	2,112,322
Marketable equity securities	5,190,097	5,215,183
Corporate obligations	828,550	985,075
Guaranteed investment contracts	-0-	26,037,068
	57,260,799	80,215,443
Less current portion of:		
Project fund	-0-	5,259,595
Debt service	7,999,514	8,089,621
Board designated	11,594,606	7,880,784
	\$ 37,666,679	\$ 58,985,443

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

	2010	2009
Investment income included with nonoperating gains:		
Interest and dividend income	\$ 822,873	\$ 2,128,404
Realized net gain (loss) on the sale of investments	(102,194)	48,624
	720,679	2,177,028
Other changes in net assets:		
Unrealized depreciation of investments	216,245	(1,474,893)
	\$ 936,924	\$ 702,135

The following schedule summarizes the fair value of securities included in investments by board designated and held by trustee that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of August 31, 2010 and 2009. The schedule further segregates the securities that have been in a gross unrealized position as of August 31, 2010 and 2009, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months are a reflection of the normal fluctuations of the market and are therefore considered temporary.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

The gross unrealized losses of twelve months or longer are reflective of current market fluctuations. The majority of the decline is attributable to several securities which industry experts expect recovery in the short-term future. These individual investments have projected recoveries in value in near term. The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of August 31, 2010 and 2009:

August 31, 2010						
	Less than 12 Months		12 Months or Longer		Total	
Description of securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common Stock	\$ 296,236	\$ 43,287	\$ 1,964,170	\$ 565,854	\$ 2,260,406	\$ 609,141
Mutual Funds	185,786	11,863	417,358	8,632	603,144	20,495
Government Obligations	3,491,817	3,628	-0-	-0-	3,491,817	3,628
Corporate Bonds	29,526	474	-0-	-0-	29,526	474
Total temporarily impaired securities	<u>\$ 4,003,365</u>	<u>\$ 59,252</u>	<u>\$ 2,381,528</u>	<u>\$ 574,486</u>	<u>\$ 6,384,893</u>	<u>\$ 633,738</u>

August 31, 2009						
	Less than 12 Months		12 Months or Longer		Total	
Description of securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common Stock	\$ 841,778	\$ 140,440	\$ 1,580,000	\$ 567,373	\$ 2,421,779	\$ 707,813
Mutual Funds	209,831	69,444	480,285	169,207	690,116	238,651
Government Obligations	514,054	2,115	-0-	-0-	514,054	2,115
Corporate Bonds	333,432	1,568	78,521	723	411,953	2,291
Total temporarily impaired securities	<u>\$ 1,899,095</u>	<u>\$ 213,567</u>	<u>\$ 2,138,806</u>	<u>\$ 737,303</u>	<u>\$ 4,037,901</u>	<u>\$ 950,870</u>

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

Major classes of assets and liabilities that are measured at fair value are categorized according to a fair value hierarchy that prioritizes the inputs to value techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

- Level 1 inputs are readily determinable using unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 inputs are derived from quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets (other than those included in Level 1) which are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The following methods and assumptions were used by the Corporation in estimating the fair value of its other financial instruments:

Cash and cash equivalents, accounts payable, accrued expenses and estimated third party settlements: The carrying amount reported in the consolidated statements of financial position for cash and cash equivalents, accounts payable, accrued expenses and estimated third party settlements approximate fair value.

Guaranteed Investment Contract: The guaranteed investment contract was held by the Corporation during 2009 and was stated at fair value as reported by the custodian. Fair value was calculated by discounting the related cash flows based on current yields of similar instruments with comparable durations. Contract value approximated fair value as reported to the Corporation by the custodian.

Long-term debt: The fair value of Corporation's long-term debt approximates carrying value.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values.

If the inputs used fall within different levels of the hierarchy, the categorization is based upon the lowest level input that is significant to the fair value measurement.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

Assets and liabilities measured at fair value on a recurring basis as of August 31, 2010 and 2009 are as follows:

	August 31, 2010			
	Total	Level 1	Level 2	Level 3
Assets whose use is limited				
Marketable equity securities	\$ 5,190,097	\$ 5,190,097	\$ -0-	\$ -0-
Mutual funds	1,597,671	1,597,671	-0-	-0-
US government obligations	6,598,035	6,598,035	-0-	-0-
Corporate obligations	828,550	828,550	-0-	-0-
	14,214,353	\$ 14,214,353	\$ -0-	\$ -0-
Cash and cash equivalents	31,523,323			
Certificates of deposit	11,523,123			
	\$ 57,260,799			
	August 31, 2009			
	Total	Level 1	Level 2	Level 3
Assets whose use is limited				
Marketable equity securities	\$ 5,215,183	\$ 5,215,183	\$ -0-	\$ -0-
Mutual funds	2,112,322	2,112,322	-0-	-0-
US government obligations	6,260,408	6,260,408	-0-	-0-
Corporate obligations	985,075	985,075	-0-	-0-
Guaranteed investment contracts	26,037,068	-0-	-0-	26,037,068
	\$ 40,610,056	\$ 14,572,988	\$ -0-	\$ 26,037,068
Cash and cash equivalents	30,103,112			
Certificates of deposit	9,502,275			
	\$ 80,215,443			

The following table sets forth a summary of changes in the fair values of the Corporation's level 3 assets for the year ended August 31, 2010.

	Guaranteed Investment Contracts	
	2010	2009
Balance, beginning of year	\$ 26,037,068	\$ 135,900,313
Purchases, sales, issuances and settlements, net	(26,037,068)	(109,863,245)
Balance, end of year	\$ -0-	\$ 26,037,068

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

7. ENDOWMENT FUNDS

The Corporation's endowment consists of individual funds established for a variety of purposes. Its endowment includes only donor-restricted endowment funds to function as endowments. Net assets associated with endowment funds, including funds designated by the Corporation to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The objective is to meet or exceed the market index, or blended market index, selected and agreed upon by the Corporation or provide an acceptable return with lower volatility or credit risk. In order to meet its needs, the investment strategy of the Corporation is to emphasize total return; that is, the aggregate return from capital appreciation and dividend and interest income. Specifically, the primary objective in the investment management for endowment fund assets shall be long-term growth of capital and to emphasize long-term growth of principal while avoiding excessive risk. Short-term volatility will be tolerated in as much as it is consistent with the volatility of a comparable market index. Endowment fund assets may be invested only in investment grade bonds rated BBB (or equivalent) or better. The board of directors has interpreted the relevant law as requiring prudent preservation of the fund and evaluates the amounts of unrestricted income and the unrealized gains and losses periodically.

The Corporation has a policy of appropriating for distribution the earned income.

The endowment net assets by type of fund as of August 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Donor-restricted endowment funds		
Permanently restricted	\$ 946,496	\$ 969,067
Total endowment funds	<u>\$ 946,496</u>	<u>\$ 969,067</u>

For 2010 and 2009, the Corporation had the following endowment-related activities:

	<u>Permanently restricted</u>	
	<u>2010</u>	<u>2009</u>
Endowment net assets, beginning of year	\$ 969,067	\$ 1,010,484
Net investment income and other changes	<u>(22,571)</u>	<u>(41,417)</u>
Endowment net assets, end of year	<u>\$ 946,496</u>	<u>\$ 969,067</u>

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

8. LONG-TERM DEBT

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, 2010, management of the Obligated Group believes that it is in compliance with all financial covenants.

Long-term debt is summarized as follows:

	2010	2009
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%.	\$ 176,071,051	\$ 176,032,222
Series 2006A, tax-exempt variable rate demand revenue bonds payable in annual principal installments commencing in fiscal 2009 through fiscal 2037. Interest rate is set weekly (payable semiannually) and averaged .56% in fiscal 2010.	18,490,000	18,845,000
Series 2006B, taxable variable rate demand revenue bonds, payable in annual principal installments commencing in fiscal 2009 through fiscal 2037. Interest rate is set weekly (payable semiannually) and averaged .56% in fiscal 2010.	12,735,000	12,920,000
Series 2002, tax-exempt variable rate demand revenue bonds, payable in annual principal installments commencing in fiscal 2004 through fiscal 2028. Interest rate set weekly (payable semiannually) and averaged .59% in fiscal year 2010.	12,960,000	13,445,000
Series 1993, tax-exempt serial and term bonds, payable in annual principal 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 SIFMA plus 385 basis points (payable semiannually) and averaged 5.09% in fiscal 2010.	27,075,000	28,055,000
Loan payable in monthly principal installments commencing in fiscal 2010 through fiscal 2014. Interest rate will be set monthly (payable monthly) using LIBOR based rates and averaged 4.36% in 2010.	6,402,500	6,940,000
Capital leases and other	7,083,206	6,025,487
Total long-term debt	260,816,757	262,262,709
Less current portion	5,727,439	5,061,554
Long-term debt, less current portion	\$ 255,089,318	\$ 257,201,155

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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

<u>Year</u>	
2011	\$ 5,727,439
2012	4,826,349
2013	3,804,024
2014	3,402,431
2015	3,350,990
Thereafter	<u>239,705,524</u>
	<u><u>\$ 260,816,757</u></u>

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 principal payments beginning in 2024.

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 principal and interest payments. There were no draws on the letter during fiscal year 2010 and 2009, and there are no outstanding amounts under this arrangement at August 31, 2010 and 2009. The letter of credit expires July 13, 2011. However in the event of a failed remarketing and also, upon the expiration of the letter of credit, the Corporation is subject to a 367 day period of interest only payments. After 367 days, the amount of the draws would be required to be repaid or refinanced.

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 principal and interest payments. There were no draws on the letter during fiscal year 2010 and 2009, and there are no outstanding amounts under this arrangement at August 31, 2010 and 2009. The letter of credit expires July 13, 2011. However in the event of a failed remarketing and also, upon the expiration of the letter of credit, the Corporation is subject to a 367 day period of interest only payments. After 367 days, the amount of the draws would be required to be repaid or refinanced.

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.

UNION HOSPITAL INC. AND SUBSIDIARIES

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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.

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 principal and interest payments. There were no draws on the letter during fiscal year 2010 and 2009, and there are no outstanding amounts under this arrangement at August 31, 2010 and 2009. The letter of credit expires July 13, 2011. However in the event of a failed remarketing and also, upon the expiration of the letter of credit, the Corporation is subject to a 367 day period of interest only payments. After 367 days, the amount of the draws would be required to be repaid or refinanced.

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 principal and interest on the Series 1993 Bonds is guaranteed under a municipal bond insurance policy.

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 3.35%. The variable rate at August 31, 2010, was 3.63%. The fair value of the swap is deemed to be immaterial and therefore any further fair value disclosures are not included in these financial statements. The swap was terminated subsequent to year-end. See Note 11.

The Corporation refinanced certain 2004 Bonds during 2009 by obtaining a five-year loan expiring in 2014. The loan agreement also requires maintenance of certain debt service income ratios, limit additional borrowings, require the maintenance of certain depository accounts, and require compliance with various other restrictive covenants.

The fair value of the 2007 fixed rate tax exempt bonds approximated \$163,793,981 as of August 31, 2010. 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. A 6.25% fixed interest rate was used for this estimation as of August 31, 2010. The fair value of variable rate debt (Series 1993, 2002, 2006A, 2006B, 2010 Loan) approximates its carrying value.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

Total interest paid on long-term debt for the years ended August 31, 2010 and 2009, aggregated approximately \$12,600,000 and \$13,200,000, respectively. Total investment income on borrowed funds held by trustee for the years ended August 31, 2010 and 2009, aggregated approximately \$364,000 and \$3,500,000, respectively. Capitalized interest costs net of associated investment income earnings aggregated approximately \$3,400,000 and \$6,700,000.

Substantially all assets and revenue serve as collateral on the aforementioned bonds and letters of credit.

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 \$10,388,710 and \$9,766,983, respectively, and \$3,781,002 and \$3,585,759, respectively, at August 31, 2010 and August 31, 2009. The following is a schedule by year of future minimum lease payments under capital leases as of August 31, 2010, that have initial or remaining lease terms in excess of one year.

Year	
2011	\$ 3,176,289
2012	2,123,401
2013	887,321
2014	437,653
2015	239,475
Thereafter	27,421
	6,891,560
Less imputed interest	608,035
Present value of minimum lease payments	\$ 6,283,525

The Corporation has operating leases for medical equipment and office space. Total rent and lease expense for 2010 and 2009 was \$11,653,240 and \$10,007,395, respectively. Future minimum lease payments under noncancelable operating leases as of August 31, 2010 that have initial or remaining lease terms in excess of one year are as follows:

Year	
2011	\$ 6,332,953
2012	5,311,359
2013	3,747,014
2014	2,393,062
2015	1,102,536
Thereafter	1,236
	\$ 18,888,160

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

9. PENSION PLANS

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).

The Corporation recognizes the funded status of its defined-benefit pension plan in its consolidated balance sheets and the changes therein within its consolidated statements of operations and changes in net assets. Funded status is defined as the difference between the projected benefit obligation and the fair value of plan assets. Prior unrecognized net actuarial losses of \$15,296,923 and \$26,383,197 have been included in the unrestricted net assets at August 31, 2010 and 2009, respectively and have not yet been recognized in net periodic pension cost. The adjustment to unrestricted net assets consisted primarily of the change in cumulative losses on the retirement plan in 2010 and 2009 and changes in the funded status.

Actuarial losses included in unrestricted net assets at August 31, 2010, and expected to be amortized in net periodic benefit cost during fiscal 2011 are \$641,243.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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, 2010 and 2009:

	2010	2009
Change in benefit obligation		
Benefit obligation, beginning of year	\$ 87,708,962	\$ 81,624,052
Service cost	1,276,887	3,963,807
Interest cost	5,621,100	5,239,237
Benefits paid	(2,084,203)	(1,835,249)
Actuarial (gain) loss	5,465,566	(1,282,885)
Effect of Settlement/Curtailment	(15,555,772)	-0-
Benefit obligation, end of year	\$ 82,432,540	\$ 87,708,962
Changes in plan assets		
Fair value of plan assets, beginning of year	\$ 59,538,221	\$ 61,194,170
Actual return on plan assets	4,011,929	(5,050,700)
Employer contributions	6,504,000	5,230,000
Benefits paid	(2,084,203)	(1,835,249)
Fair value of plan assets, end of year	\$ 67,969,947	\$ 59,538,221
Funded status		
Funded status of the plan, end of year	\$ (14,462,593)	\$ (28,170,741)

No plan assets are expected to be returned to the Corporation during the fiscal year ended August 31, 2010.

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

	2010	2009
Components of net periodic benefit cost		
Service cost	\$ 1,276,887	\$ 3,963,807
Interest cost	5,621,100	5,239,237
Expected return on plan assets	(4,616,979)	(4,674,132)
Actuarial loss	1,601,118	977,885
Net periodic benefit cost	\$ 3,882,126	\$ 5,506,797

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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

Year Ending August 31,	
2011	\$ 2,785,126
2012	3,181,388
2013	3,485,856
2014	3,843,714
2015	4,125,354
2016-2020	26,702,211
	<u>\$ 44,123,649</u>

The weighted-average assumptions used to determine the Plan's projected benefit obligation (PBO) and net periodic benefit costs (NPBC) for the years ended August 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Discount rate	6.5%	6.5%
Expected return on plan assets	7.5%	7.5%
Rate of compensation increase - PBO	0.0%	3.0%
Rate of compensation increase - NPBC	3.0%	5.0%

The principal long-term determinant of a portfolio's investment return is its asset allocation. The Plan's allocation includes growth assets (51%) and fixed income (41%) investments and other (8%). 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, 2010 and 2009, by asset category, are as follows:

	<u>2010</u>	<u>2009</u>
Mutual funds - equity funds	51%	60%
Mutual funds - bond funds	41%	35%
Alternative investments	0%	0%
Other	8%	5%
	<u>100%</u>	<u>100%</u>

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

The following is an analysis of fair value of the major classes of plan assets of August 31, 2010:

	<u>Fair Value</u>
Cash and equivalents	\$ 3,986,445
Mutual funds - equity funds	34,635,869
Mutual funds - bond funds	28,076,887
Private equity funds	<u>1,270,746</u>
Total	<u>\$ 67,969,947</u>

Fair value of cash and equivalents, equity funds, and bond funds are based on the basis of quoted prices in active markets (Level 1 inputs). The fair value of the private equity funds are based on valuation techniques. The change in value on the private equity funds from August 31, 2009 to August 31, 2010 consists of realized and unrealized gains and losses, purchases, and sales.

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 \$6,504,000 to the pension plan in 2011 and will meet the required funding amounts for 2010. The Corporation elected to freeze the Plan in 2010, but will continue to fund the plan as required.

The Corporation also has a 403b discretionary defined contribution plan for which contributions during 2010 were approximately \$2,200,000. There were no contributions during 2009.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2010 AND 2009

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.

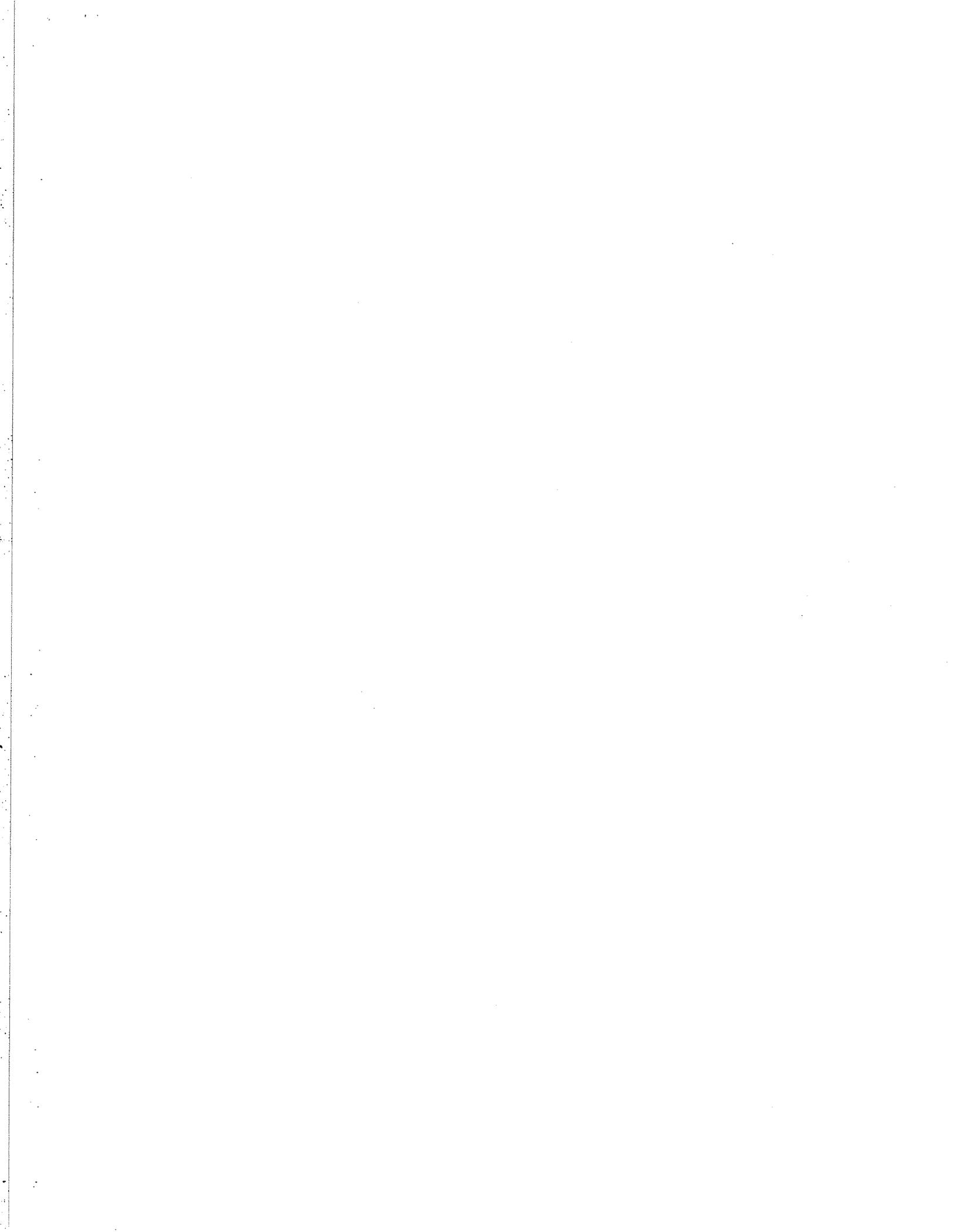
11. SUBSEQUENT EVENTS

During September of 2010, the Corporation terminated the Total Return Swap derivative associated with the 1993 IHFFA Revenue bond issue. The underlying bonds were converted to fixed rates of 5.125% and 5.25%.

The Corporation anticipates refinancing the 2006A and 2002 Bonds and borrowing an additional amount for certain property and equipment additions and renovations. The total borrowing is expected to be approximately \$56,000,000.

The Corporation instituted an early retirement program in three phases at the end of the year. Phase 1 applied to eligible employees 60 years of age and above, Phase 2 to eligible employees 57 years and above, and Phase 3 to eligible employees 55 years and above. Employees who applied and qualified under the program receive monthly annuities based upon the value of their pension, as well as COBRA benefits for up to eighteen months at the current employee costs. Upon the 19th month and until reaching the age of 65, the Corporation will deposit \$500 a month into a benefits account per qualifying retiree to be used for health benefits. The effective dates for phase 1, 2, and 3 were September 3, October 1, and November 3, 2010, respectively. As of the end of October 2010, approximately 84 employees had applied for and resigned under the program.

SUPPLEMENTARY INFORMATION



UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS AUGUST 31, 2010

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
Liabilities and net assets					
Current liabilities					
Accounts payable and other current liabilities	22,115,897	\$ 421,054	\$ 250,222	\$ (330,601)	\$ 22,456,572
Salaries, wages and related liabilities	15,739,402	20,472	-0-	-0-	15,759,874
Accrued interest	5,769,510	-0-	-0-	-0-	5,769,510
Current portion of long-term debt	5,727,439	-0-	-0-	-0-	5,727,439
Total current liabilities	49,352,248	441,526	250,222	(330,601)	49,713,395
Long-term liabilities					
Long-term debt, less current portion	255,089,318	-0-	-0-	-0-	255,089,318
Deferred revenue	507,720	-0-	-0-	-0-	507,720
Pension liability	14,462,593	-0-	-0-	-0-	14,462,593
Total long-term liabilities	270,059,631	-0-	-0-	-0-	270,059,631
Total liabilities	319,411,879	441,526	250,222	(330,601)	319,773,026
Net assets					
Unrestricted	127,903,123	1,295,256	71,121	(1,366,359)	127,903,141
Temporarily restricted	6,783,414	-0-	-0-	-0-	6,783,414
Permanently restricted	946,496	-0-	-0-	-0-	946,496
Total net assets	135,633,033	1,295,256	71,121	(1,366,359)	135,633,051
Total liabilities and net assets	\$ 455,044,912	\$ 1,736,782	\$ 321,343	\$ (1,696,960)	\$ 455,406,077

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED AUGUST 31, 2010

	Union Hospital	Union Hospital Clinton	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
Operating revenue							
Net patient service revenue	\$ 367,055,117	\$ 26,614,157	\$ 393,669,274	\$ -0-	\$ 973,103	\$ (689,292)	\$ 393,953,085
Other revenue	8,332,059	510,706	8,842,765	1,739,524	840	(1,547,758)	9,035,371
Total operating revenue	375,387,176	27,124,863	402,512,039	1,739,524	973,943	(2,237,050)	402,988,456
Operating expenses							
Salaries and wages	109,751,619	9,880,918	119,632,537	287,530	-0-	-0-	119,920,067
Employee benefits	28,318,599	2,529,909	30,848,508	116,698	-0-	-0-	30,965,206
Supplies and drugs	65,572,990	3,475,948	69,048,938	-0-	95,219	-0-	69,144,157
Physician services	8,425,305	630,500	9,055,805	-0-	-0-	-0-	9,055,805
Contract services	67,762,532	808,696	68,571,228	-0-	888,845	-0-	69,460,073
Rent and leases	11,013,580	639,660	11,653,240	-0-	-0-	-0-	11,653,240
Utilities, supplies, and other	29,492,527	3,559,283	33,051,810	791,759	-0-	(2,237,050)	31,606,519
Provision for bad debts	26,750,703	4,032,915	30,783,618	910	-0-	-0-	30,784,528
Depreciation and amortization	21,005,914	915,663	21,921,577	1,421	9,657	-0-	21,932,655
Interest	8,505,594	7,910	8,513,504	-0-	-0-	-0-	8,513,504
Total operating expenses	376,599,363	26,481,402	403,080,765	1,198,318	993,721	(2,237,050)	403,035,754
Income (loss) from operations	(1,212,187)	643,461	(568,726)	541,206	(19,778)	-0-	(47,298)
Nonoperating gains (losses)							
Investment income	613,478	10,703	624,181	76,719	-0-	19,779	720,679
Other	441,589	(411)	441,178	-0-	-0-	(617,906)	(176,728)
Total nonoperating revenues	1,055,067	10,292	1,065,359	76,719	-0-	(598,127)	543,951
Net income (loss)	\$ (157,120)	\$ 653,753	\$ 496,633	\$ 617,925	\$ (19,778)	\$ (598,127)	\$ 496,653

See Report of Independent Auditors on Page 1 and 2.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED AUGUST 31, 2009

	Union Hospital	Union Hospital Clinton	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
Operating revenue							
Net patient service revenue	\$ 369,634,801	\$ 25,180,324	\$ 394,815,125	\$ -0-	\$ 775,683	\$ (566,633)	\$ 395,024,175
Other revenue	8,753,480	740,080	9,493,560	1,502,074	0	(1,236,597)	9,759,037
Total operating revenue	<u>378,388,281</u>	<u>25,920,404</u>	<u>404,308,685</u>	<u>1,502,074</u>	<u>775,683</u>	<u>(1,803,230)</u>	<u>404,783,212</u>
Operating expenses							
Salaries and wages	103,316,135	9,548,735	112,864,870	232,537	-0-	-0-	113,097,407
Employee benefits	27,918,343	2,532,293	30,450,636	95,588	-0-	-0-	30,546,224
Supplies and drugs	49,314,667	3,569,942	52,884,609	-	105,343	-0-	52,989,952
Physician services	8,229,708	546,467	8,776,175	-0-	-0-	-0-	8,776,175
Contract services	101,087,951	592,130	101,680,081	-0-	720,895	-0-	102,400,976
Rent and leases	9,438,151	569,244	10,007,395	-0-	-0-	-0-	10,007,395
Utilities, supplies, and other	26,922,495	3,615,965	30,538,460	-0-	-0-	(1,623,153)	29,705,388
Provision for bad debts	24,993,019	2,912,050	27,905,069	764,631	-0-	-0-	28,669,700
Depreciation and amortization	13,282,127	905,777	14,187,904	4,348	4,521	-0-	14,196,773
Interest	2,676,076	3,757	2,679,833	-0-	-0-	-0-	2,679,833
Total operating expenses	<u>367,178,672</u>	<u>24,796,360</u>	<u>391,975,032</u>	<u>1,887,185</u>	<u>830,759</u>	<u>(1,623,153)</u>	<u>393,069,823</u>
Income (loss) from operations	11,209,609	1,124,044	12,333,653	(385,111)	(55,076)	(180,077)	11,713,389
Nonoperating gains							
Investment income	2,048,851	18,828	2,067,679	54,274	(35,687)	90,762	2,177,028
Other	(191,809)	112,484	(79,325)	-0-	-0-	510,913	431,588
Total nonoperating revenues	<u>1,857,042</u>	<u>131,312</u>	<u>1,988,354</u>	<u>54,274</u>	<u>(35,687)</u>	<u>601,675</u>	<u>2,608,616</u>
Net income (loss)	<u>\$ 13,066,651</u>	<u>\$ 1,255,356</u>	<u>\$ 14,322,007</u>	<u>\$ (330,837)</u>	<u>\$ (90,763)</u>	<u>\$ 421,598</u>	<u>\$ 14,322,005</u>