

**DeKalb Memorial Hospital, Inc.
d/b/a DeKalb Health**

Accountants' Report and Consolidated Financial Statements

September 30, 2011 and 2010



DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
September 30, 2011 and 2010

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Independent Accountants' Report

Finance and Audit Committee
DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Auburn, Indiana

We have audited the accompanying consolidated balance sheets of DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health (Hospital) as of September 30, 2011 and 2010, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital'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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall 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 financial position of DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health as of September 30, 2011 and 2010, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

December 1, 2011

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Consolidated Balance Sheets September 30, 2011 and 2010

| | 2011 | 2010 |
|---|---------------|---------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 2,974,361 | \$ 6,285,304 |
| Accounts receivable | | |
| Patient services, net of allowance for uncollectible accounts; 2011 - \$1,021,000, 2010 - \$1,205,000 | 7,159,342 | 7,552,453 |
| Other | 447,704 | 302,444 |
| Estimated amounts due from third-party payers | 384,135 | 214,519 |
| Inventories | 903,158 | 522,359 |
| Prepaid expenses and other | 779,746 | 363,595 |
| Total current assets | 12,648,446 | 15,240,674 |
| Assets Limited as to Use | | |
| Internally designated | 12,995,464 | 13,242,538 |
| Externally restricted by donor | 112,897 | 84,218 |
| Held by trustee | 1,091,332 | 1,181,756 |
| Total assets limited as to use | 14,199,693 | 14,508,512 |
| Property and Equipment, net | 36,986,222 | 30,290,559 |
| Other Assets | 91,838 | 135,165 |
| Total assets | \$ 63,926,199 | \$ 60,174,910 |
| Liabilities and Net Assets | | |
| Current Liabilities | | |
| Current maturities of long-term debt | \$ 1,235,563 | \$ 1,149,456 |
| Accounts payable | 1,764,329 | 1,546,435 |
| Accrued salaries, wages and related liabilities | 2,347,591 | 2,230,299 |
| Other accrued liabilities | 721,302 | 688,496 |
| Total current liabilities | 6,068,785 | 5,614,686 |
| Long-Term Debt, less current maturities | 10,785,896 | 6,568,489 |
| Total liabilities | 16,854,681 | 12,183,175 |
| Net Assets | | |
| Unrestricted | 46,958,621 | 47,907,517 |
| Temporarily restricted | 112,897 | 84,218 |
| Total net assets | 47,071,518 | 47,991,735 |
| Total liabilities and net assets | \$ 63,926,199 | \$ 60,174,910 |

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Consolidated Statements of Operations Years Ended September 30, 2011 and 2010

| | 2011 | 2010 |
|--|---------------------|---------------------|
| Unrestricted Revenue, Gains and Other Support | | |
| Net patient service revenue | \$ 44,391,045 | \$ 43,080,908 |
| Other | 5,264,472 | 1,726,484 |
| Net assets released from restrictions used for operations | <u>34,031</u> | <u>29,069</u> |
| Total unrestricted revenue, gains and other support | <u>49,689,548</u> | <u>44,836,461</u> |
| Expenses | | |
| Salaries and wages | 19,662,631 | 17,525,387 |
| Payroll taxes and employee benefits | 5,887,115 | 6,073,138 |
| Purchased medical services | 3,889,193 | 3,263,623 |
| Medical supplies and drugs | 6,883,015 | 4,068,153 |
| Insurance | 546,910 | 572,015 |
| Depreciation and amortization | 3,805,396 | 3,523,183 |
| Interest | 233,109 | 390,463 |
| Provision for uncollectible accounts | 3,712,798 | 3,267,512 |
| Other | <u>5,986,542</u> | <u>5,224,979</u> |
| Total expenses | <u>50,606,709</u> | <u>43,908,453</u> |
| Operating Income (Loss) | <u>(917,161)</u> | <u>928,008</u> |
| Other Income (Expense) | | |
| Contributions received | 3,382 | 12,734 |
| Investment return, dividends, interest and realized gains | 718,551 | 1,132,576 |
| Investment return, change in unrealized gains (losses) on trading securities | (914,604) | 372,412 |
| Loss on investment in equity investee | <u>(13,669)</u> | <u>(42,921)</u> |
| Total other income (expense) | <u>(206,340)</u> | <u>1,474,801</u> |
| Excess (Deficiency) of Revenue over Expenses | (1,123,501) | 2,402,809 |
| Net assets released from restrictions used for purchase of property and equipment | <u>174,605</u> | <u>605,826</u> |
| Increase (Decrease) in Unrestricted Net Assets | <u>\$ (948,896)</u> | <u>\$ 3,008,635</u> |

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2011 and 2010

| | 2011 | 2010 |
|--|----------------------|----------------------|
| Unrestricted Net Assets | | |
| Excess (deficiency) of revenue over expenses | \$ (1,123,501) | \$ 2,402,809 |
| Net assets released from restrictions used for purchase of property and equipment | <u>174,605</u> | <u>605,826</u> |
| Increase (decrease) in unrestricted net assets | <u>(948,896)</u> | <u>3,008,635</u> |
| Temporarily Restricted Net Assets | | |
| Contributions received | 237,315 | 33,255 |
| Net assets released from restrictions | <u>(208,636)</u> | <u>(634,895)</u> |
| Increase (decrease) in temporarily restricted net assets | <u>28,679</u> | <u>(601,640)</u> |
| Increase (Decrease) in Net Assets | (920,217) | 2,406,995 |
| Net Assets, Beginning of Year | <u>47,991,735</u> | <u>45,584,740</u> |
| Net Assets, End of Year | <u>\$ 47,071,518</u> | <u>\$ 47,991,735</u> |

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Consolidated Statements of Cash Flows Years Ended September 30, 2011 and 2010

| | <u>2011</u> | <u>2010</u> |
|--|---------------------|---------------------|
| Operating Activities | | |
| Change in net assets | \$ (920,217) | \$ 2,406,995 |
| Items not requiring (providing) operating cash flows | | |
| Depreciation and amortization | 3,805,396 | 3,523,183 |
| Loss on sale of property and equipment | 17,752 | - |
| Net realized and unrealized (gain) loss on investments | 639,014 | (1,090,130) |
| Restricted contributions | (237,313) | (33,255) |
| Loss on investment in equity investee | 13,669 | 42,921 |
| Changes in | | |
| Patient accounts receivable | 393,111 | 644,993 |
| Other current assets and liabilities | (667,444) | (877,033) |
| Net cash provided by operating activities | <u>3,043,968</u> | <u>4,617,674</u> |
| Investing Activities | | |
| Purchase of property and equipment | (9,881,029) | (1,959,281) |
| Proceeds from sale of property and equipment | 6,000 | 19,500 |
| Purchase of investments | (5,622,185) | (19,133,138) |
| Proceeds from disposition of investments | 5,291,990 | 19,573,453 |
| Acquisition of covenant not to compete | (539,782) | - |
| Net cash used in investing activities | <u>(10,745,006)</u> | <u>(1,499,466)</u> |
| Financing Activities | | |
| Proceeds from issuance of long-term debt | 5,317,494 | - |
| Principal payments on long-term debt | (1,164,712) | (1,105,096) |
| Proceeds from restricted contributions | 237,313 | 33,255 |
| Net cash provided by (used in) financing activities | <u>4,390,095</u> | <u>(1,071,841)</u> |
| Increase (Decrease) in Cash and Cash Equivalents | (3,310,943) | 2,046,367 |
| Cash and Cash Equivalents, Beginning of Year | <u>6,285,304</u> | <u>4,238,937</u> |
| Cash and Cash Equivalents, End of Year | <u>\$ 2,974,361</u> | <u>\$ 6,285,304</u> |
| Supplemental Cash Flows Information | | |
| Interest paid (net of amount capitalized) | \$ 225,626 | \$ 397,946 |
| Fixed assets additions in accounts payable | 227,406 | 361,121 |
| Capital lease obligation incurred for property and equipment | 150,732 | 19,592 |

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2011 and 2010

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation

DeKalb Memorial Hospital, Inc., d/b/a DeKalb Health (Hospital), a not-for-profit organization, provides inpatient and outpatient health care services generally to residents of DeKalb County, Indiana and contiguous counties. Expenses relate to the provision of medical care and related general and administrative costs. The consolidated financial statements include the accounts of DeKalb Memorial Hospital, Inc., d/b/a DeKalb Health and its wholly owned subsidiary, DeKalb Memorial Pharmicare LLC (DMP), a not-for-profit limited liability company which operates a retail pharmacy within the Hospital facility. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Hospital considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At September 30, 2011, cash equivalents consisted primarily of an overnight sweep investment account which is collateralized by short term securities and had an approximate value of \$3,323,000. At September 30, 2010, cash equivalents consisted primarily of money market accounts.

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to \$250,000. At September 30, 2011, the Hospital's cash accounts did not exceed federally insured limits.

Pursuant to legislation enacted in 2010, the FDIC will fully insure all non-interest-bearing transaction accounts through December 31, 2012, at all FDIC-insured institutions.

Investments and Investment Return

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. The Hospital has classified substantially all of its investments in debt and equity securities as trading securities. The investment in equity investee is reported on the equity method of accounting. Investment return includes dividend, interest and other investment income and realized and unrealized gains and losses on investments carried at fair value.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in unrestricted net assets. Other investment return is reflected in the statements of operations and changes in net assets as unrestricted, temporarily

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2011 and 2010

restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

Assets Limited as to Use

Assets limited as to use include (1) assets held by a trustee under terms of a bond indenture agreement, (2) assets restricted by donors and (3) assets set aside by the Board of Directors for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the Hospital, if any, are included in current assets.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Hospital bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Inventories

Supply inventories are stated at the lower of cost, determined using the first-in, first-out (FIFO) method or market.

Acquisition of Pharmacy Operations and Covenant Not to Compete

On November 8, 2010, the Hospital acquired the operations and certain assets of DeKalb PharmaCare, Inc., (the Acquiree) a retail pharmacy providing services within the Hospital's facility, for \$831,250. These assets were contributed by the Hospital to DMP. As a part of the acquisition, the owner of the Acquiree entered into a covenant not to compete within a 25-mile radius of the Hospital facility for a two year period from the date of the sale.

Based on fair value at the time of the acquisition, DMP recorded this purchase as follows:

| | | |
|-------------------------|----|----------------|
| Covenant not to compete | \$ | 539,782 |
| Inventories | | 281,250 |
| Supplies | | 10,218 |
| | | <hr/> |
| | \$ | <u>831,250</u> |

The covenant not to compete is being amortized on a straight-line basis over the two-year term of the agreement. At September 30, 2011, accumulated amortization was \$247,400, which was also the total of amortization expense recognized during 2011. The covenant not to compete is included in prepaid expenses and other current assets in the consolidated balance sheet.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2011 and 2010

Property and Equipment

Property and equipment are recorded at cost and are depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

The Hospital capitalizes interest costs as a component of construction in progress, based on the weighted-average rates paid for long-term borrowing. Total interest incurred was:

| | <u>2011</u> | <u>2010</u> |
|-----------------------------------|-------------------|-------------------|
| Interest costs capitalized | \$ 148,935 | \$ - |
| Interest costs charged to expense | <u>233,109</u> | <u>390,463</u> |
| Total interest incurred | <u>\$ 382,044</u> | <u>\$ 390,463</u> |

Patient Accounts Receivable Financing

Under a credit financing agreement, qualified self-pay patients can receive interest-bearing loans from an independent financial institution to pay their receivable balances to the Hospital. The transfer of these receivables is with full recourse to the Hospital. At September 30, 2011 and 2010, these receivables totaled \$170,358 and \$437,821, respectively. The Hospital has recorded a liability for estimated required repayments of \$38,826 and \$0 on these loans at September 30, 2011 and 2010, respectively.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Temporarily restricted net assets at September 30, 2011 and 2010, were available for the purchase of building improvements and equipment and operational expenses of various Hospital service lines.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as adjustments become known.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2011 and 2010

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges forgone were \$619,117 and \$831,680 in 2011 and 2010, respectively.

Contributions

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

Estimated Malpractice Costs

The Hospital participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the Hospital, with the balance paid by the State of Indiana Patient Compensation Fund. The Hospital carries a claims-made basis insurance policy covering the Hospital's \$250,000 of exposure per claim with a \$5,000,000 annual aggregate. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents, including an estimate for claims incurred but not yet reported. Based upon the Hospital's claim experience, an accrual of \$75,000 has been made at September 30, 2011 and 2010, which is included in other accrued liabilities. It is reasonably possible that this estimate could change materially in the near term.

Pension Plan

The Hospital has a noncontributory defined contribution pension plan covering all eligible employees. The Hospital's cost each year is determined by the plan as a specific percentage of each participating employee's salary. It is the Hospital's policy to fund pension costs as accrued. Pension expense was \$869,693 and \$1,221,607 in 2011 and 2010, respectively.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2011 and 2010

Self Insurance

The Hospital has elected to self-insure certain costs related to employee health programs. Costs resulting from noninsured losses are charged to income when incurred. The Hospital has purchased insurance that limits its exposure for individual claims to \$85,000 per covered employee and that limits its aggregate exposure to \$3,400,000.

Income Taxes

The Hospital has been recognized as exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income. The Hospital files tax returns in the U.S. federal jurisdiction. With a few exceptions, the Hospital is no longer subject to U.S. federal or state examinations by tax authorities for years before 2008.

The Hospital has elected to have DMP's income taxed as a partnership under provisions of the Internal Revenue Code and a similar section of the state income tax law. Therefore, taxable income or loss is reported to the Hospital for inclusion in its tax returns and no provision for federal and state income taxes is included in these statements.

DMP is subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for all periods since its inception in 2010.

Excess (Deficiency) of Revenue Over Expenses

The statements of operations include excess (deficiency) of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess (deficiency) of revenue over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare. Inpatient acute care services and substantially all outpatient services provided 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. The prospectively determined rates are not subject to retroactive adjustment although determination of certain elements of the rates can occur after the current period and generate final settlement after submission of annual cost reports by the Hospital and audits thereof by the fiscal intermediary.

Medicaid. The Hospital is reimbursed for Medicaid inpatient and outpatient services at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2011 and 2010

Other Reimbursement Arrangements. The Hospital also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Approximately 40% of net patient service revenue is from participation in the Medicare program for the years ended September 30, 2011 and 2010. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

A summary of gross patient service revenue and contractual adjustments for the years ended September 30, 2011 and 2010, are as follows:

| | <u>2011</u> | <u>2010</u> |
|-------------------------------------|----------------------|----------------------|
| Gross patient service revenue | | |
| Routine services | \$ 9,805,629 | \$ 8,209,927 |
| Ancillary services | | |
| Inpatient | 13,777,407 | 13,396,153 |
| Outpatient | 69,539,915 | 66,168,710 |
| Charity care | <u>(619,117)</u> | <u>(831,680)</u> |
| Total gross patient service revenue | 92,503,834 | 86,943,110 |
| Contractual adjustments | <u>(48,112,789)</u> | <u>(43,862,202)</u> |
| Net patient service revenue | <u>\$ 44,391,045</u> | <u>\$ 43,080,908</u> |

Note 3: Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are area residents and are generally insured under third-party payer agreements. The mix of receivables from patients and third-party payers at September 30, 2011 and 2010, was:

| | <u>2011</u> | <u>2010</u> |
|----------------------|-------------|-------------|
| Commercial insurance | 38% | 43% |
| Medicare | 19 | 26 |
| Medicaid | 5 | 5 |
| Self-pay | 32 | 22 |
| Other | <u>6</u> | <u>4</u> |
| | <u>100%</u> | <u>100%</u> |

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2011 and 2010

Note 4: Investments and Investment Return

Assets Limited as to Use

Assets limited as to use at September 30, include:

| | 2011 | 2010 |
|---------------------------------|---------------|---------------|
| Cash and money market funds | \$ 1,251,672 | \$ 1,350,895 |
| Common stocks | - | 70 |
| Mutual funds | | |
| Equity mutual funds | | |
| Large blend and growth funds | 4,401,001 | 4,033,495 |
| Intermediate term growth funds | 1,436,408 | 1,976,033 |
| Small blend and growth funds | 478,340 | 592,775 |
| International funds | 3,328,500 | 3,161,890 |
| Other funds | 1,130,790 | 1,299,332 |
| Fixed income mutual funds | 2,172,982 | 2,094,022 |
| | \$ 14,199,693 | \$ 14,508,512 |
| Internally designated | \$ 12,995,464 | \$ 13,242,538 |
| Externally restricted by donors | 112,897 | 84,218 |
| Held by trustee | 1,091,332 | 1,181,756 |
| | \$ 14,199,693 | \$ 14,508,512 |

Total investment return is comprised of the following:

| | 2011 | 2010 |
|---|--------------|--------------|
| Interest and dividend income | \$ 442,961 | \$ 414,858 |
| Realized gains on sales of securities | 275,590 | 717,718 |
| Unrealized gains (losses) on trading securities | (914,604) | 372,412 |
| Total investment return | \$ (196,053) | \$ 1,504,988 |

Total investment return is reflected in the statements of operations and changes in net assets as follows:

| | 2011 | 2010 |
|-------------------------|--------------|--------------|
| Unrestricted net assets | | |
| Other income | \$ (196,053) | \$ 1,504,988 |

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2011 and 2010

Note 5: Property and Equipment

Property and equipment at September 30 consists of:

| | 2011 | 2010 | Estimated Useful Life |
|--|---------------|---------------|-----------------------|
| Land | \$ 220,118 | \$ 220,118 | |
| Land improvements | 1,696,200 | 1,696,200 | 5-15 years |
| Hospital buildings | 35,294,475 | 34,129,281 | 5-40 years |
| Medical office buildings | 9,684,698 | 9,625,063 | 5-40 years |
| Equipment | 17,954,785 | 16,674,321 | 5-20 years |
| Medical office equipment | 55,281 | 55,281 | 5-20 years |
| Equipment held under capital lease | 160,092 | 28,413 | 5 years |
| Construction in progress | 7,846,904 | 631,455 | |
| | 72,912,553 | 63,060,132 | |
| Less accumulated depreciation and amortization | (35,926,331) | (32,769,573) | |
| | \$ 36,986,222 | \$ 30,290,559 | |

The Hospital has entered into capital leases for certain medical equipment. This equipment is included in property and equipment with an original cost of \$160,092 and \$28,413 and accumulated amortization of approximately \$30,666 and \$4,735 at September 30, 2011 and 2010, respectively. The capital lease obligations are collateralized by the leased equipment.

Note 6: Investment in Equity Investee

The Hospital has a 50% ownership in a joint venture, which operates an occupational health clinic (RediMed DeKalb LLC) in Auburn, Indiana. The Hospital accounts for the investment under the equity method of accounting. As a result, the Hospital recognized a loss of \$13,669 and \$42,921 related to its investment in RediMed DeKalb LLC for the years ended September 30, 2011 and 2010, respectively, which is included in other nonoperating income in the statements of operations.

The carrying value of this investment at September 30, 2011 and 2010, is a liability for approximately \$207,000 and \$193,000, respectively, related to losses in excess of the Hospital's investment in RediMed DeKalb LLC.

Note 7: Medical Office Buildings

The Hospital owns medical office buildings (MOBs) adjacent to the Hospital, and leases space in these MOBs to physicians under various operating leases. Other revenue for the years ended September 30, 2011 and 2010, includes gross rental income of \$706,749 and \$664,917, respectively, from cancelable and noncancelable leases of the medical office building.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2011 and 2010

The following is a schedule, by year, of future minimum rental income to be received under operating leases which have initial or remaining noncancelable terms in excess of one year as of September 30, 2011:

| | |
|------|-------------------|
| 2012 | \$ 207,678 |
| 2013 | 205,942 |
| 2014 | 209,310 |
| 2015 | 176,987 |
| 2016 | <u>105,434</u> |
| | <u>\$ 905,351</u> |

Note 8: Long-Term Debt

Long-term debt at September 30, consists of the following:

| | <u>2011</u> | <u>2010</u> |
|---|----------------------|---------------------|
| Hospital Authority of DeKalb County, Indiana, Revenue Bonds, Series 2006: Series A and B Bonds, payable through August 1, 2016, interest at 3.9% to 5.0% (A) | \$ 6,550,065 | \$ 7,698,353 |
| Note payable to bank, maturity date of December 14, 2021 (B) | 5,317,493 | - |
| Capital lease obligations, at various imputed interest rates | <u>153,901</u> | <u>19,592</u> |
| | 12,021,459 | 7,717,945 |
| Less current maturities | <u>(1,235,563)</u> | <u>(1,149,456)</u> |
| | <u>\$ 10,785,896</u> | <u>\$ 6,568,489</u> |

(A) The Hospital Authority of DeKalb County (Authority) was established in accordance with the Indiana Hospital Authority Act to issue tax-exempt revenue bonds for hospitals within DeKalb County. Payments due under the bonds are made from amounts received by the Authority from the Hospital under a loan agreement. The Hospital's financial statements reflect the debt and related transactions of the Authority, on behalf of the Hospital, as if the Hospital had issued the tax-exempt bonds.

The Series 2006 Bonds mature serially in varying annual amounts through August 2016. At its option, the Hospital may redeem outstanding Series 2006 Bonds at any time on or after August 1, 2011.

The Loan Agreement for the Series 2006 Bonds grants a security interest in certain of the Hospital's real estate and portions of buildings, and contains certain covenants requiring the Hospital to maintain certain debt service coverage levels among other requirements.

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(B) In 2011, the Hospital entered into a \$9,000,000 revolving bank line of credit expiring in 2021. At September 30, 2011 there was \$5,317,493 borrowed against this line. The note is secured by certain investments. Available credit under the arrangement is reduced by \$900,000 per year starting on December 14, 2012.

Interest varies at a rate under, but based on the bank's prime rate, and was 2.99% on September 30, 2011. Interest on the note is payable monthly. The Hospital has the option to convert to a fixed interest rate during the term of the note at the following rates:

| | |
|--|-------|
| Beginning of note term through December 14, 2013 | 5.75% |
| December 15, 2014 to December 14, 2016 | 5.24 |
| December 15, 2016 to December 14, 2018 | 4.65 |
| December 15, 2018 to December 14, 2021 | 4.05 |

Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at September 30, 2011, are:

| | |
|------------|----------------------|
| 2012 | \$ 1,235,563 |
| 2013 | 1,285,359 |
| 2014 | 1,342,079 |
| 2015 | 1,400,768 |
| 2016 | 1,433,289 |
| Thereafter | <u>5,324,401</u> |
| | <u>\$ 12,021,459</u> |

Note 9: Disclosures About Fair Value of Assets and Liabilities

ASC Topic 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. The Hospital has no

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liabilities measured at fair value on a recurring basis. Additionally, the Hospital has no assets or liabilities measured at fair value on a nonrecurring basis.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include money market funds, common stocks, equity mutual funds and fixed income mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. The Hospital has no Level 2 securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Hospital has no Level 3 securities.

The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2011 and 2010:

| | 2011 | | | |
|-----------------------------------|-------------------|---|--|--|
| | Fair Value | Fair Value Measurements Using | | |
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Investments | | | | |
| Money market funds | \$ 1,138,775 | \$ 1,138,775 | \$ - | \$ - |
| Equity mutual funds | | | | |
| Large blend and growth funds | 4,401,001 | 4,401,001 | - | - |
| Intermediate term growth funds | 1,436,408 | 1,436,408 | - | - |
| Small blend and growth funds | 478,340 | 478,340 | - | - |
| International funds | 3,328,500 | 3,328,500 | - | - |
| Other funds | 1,130,790 | 1,130,790 | - | - |
| Fixed income mutual funds | 2,172,982 | 2,172,982 | - | - |

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| | 2010 | | | |
|--------------------------------------|--------------|---|---|--|
| | Fair Value | Fair Value Measurements Using | | |
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Investments | | | | |
| Money market funds | \$ 1,266,677 | \$ 1,266,677 | \$ - | \$ - |
| Common stocks | 70 | 70 | - | - |
| Mutual funds | | | | |
| Equity funds | | | | |
| Large blend and growth funds | 4,033,495 | 4,033,495 | - | - |
| Intermediate term growth funds | 1,976,033 | 1,976,033 | - | - |
| Small blend and growth funds | 592,775 | 592,775 | - | - |
| International funds | 3,161,890 | 3,161,890 | - | - |
| Other funds | 1,299,332 | 1,299,332 | - | - |
| Fixed income mutual funds | 2,094,022 | 2,094,022 | - | - |

Note 10: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in Notes 1 and 2.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Note 1.

Regulatory Investigations

The U.S. Department of Justice, the Internal Revenue Service and other federal agencies routinely conduct regulatory investigations and compliance audits of health care providers. The Hospital is subject to these regulatory efforts. Management is currently unaware of any regulatory matters

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which may have a material adverse effect on the Hospital's financial position or results of operations.

Investments

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying balance sheets.

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. At September 30, 2011 and 2010, no accrual of potential losses from litigation was recorded other than in relation to the Hospital's estimated malpractice insurance costs as discussed in Note 1. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Current Economic Conditions

The current protracted economic decline continues to present hospitals with difficult circumstances and challenges, which in some cases have resulted in large and unanticipated declines in the fair value of investments and other assets, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values and allowances for accounts receivable that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.

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Note 11: Related Party Transactions

The Hospital and DeKalb County Community Memorial Hospital Foundation, Inc. (Foundation) are related parties that are not financially interrelated organizations. The Foundation was established to receive and administer funds and to apply them for the acquisition, construction, establishment and operation of a Community Memorial Hospital for DeKalb County, Indiana. In the absence of donor restrictions, funds are distributed as determined by the Foundation's Board of Directors, which are separately appointed from that of the Hospital.

In 2011 and 2010, the Hospital received \$162,000 and \$0, respectively, in donations from the Foundation.

Note 12: Functional Expenses

The Hospital provides health care services to residents within its geographic location. Expenses related to providing these services are as follows:

| | <u>2011</u> | <u>2010</u> |
|----------------------------|----------------------|----------------------|
| Health care services | \$ 45,143,119 | \$ 39,641,115 |
| General and administrative | <u>5,463,590</u> | <u>4,267,338</u> |
| | <u>\$ 50,606,709</u> | <u>\$ 43,908,453</u> |

Note 13: Construction Commitment

During 2010, the Hospital entered into a \$9,100,000 contract with an architectural firm to build out approximately 21,000 square feet in an existing facility and to construct approximately 6,000 square feet of additional space to house emergency department, imaging department and intensive care unit operations. At September 30, 2011, approximately \$2,274,000 had not been incurred on this project.

Note 14: Subsequent Events

Subsequent to the end of the year, the Hospital received equipment associated with two capital lease arrangements for medical equipment entered into in 2011. The leases are for a period of 5 years commencing in October 2011. The long-term liability and associated capital assets recorded by the Hospital total approximately \$2,200,000.

Subsequent events have been evaluated through December 1, 2011, which is the date the financial statements were available to be issued.