Indiana Orthopaedic Hospital, LLC

Accountants' Report and Consolidated Financial Statements

December 31, 2011 and 2010

Indiana Orthopaedic Hospital, LLC
December 31, 2011 and 2010

Contents

BKD LLP
CPAs & Advisors

201 N. Illinois Street, Suite 700
P.O. Box 44998
Indianapolis, IN 46244-0998
317.383.4000 Fax 317.383.4200 www.bkd.com

Independent Accountants' Report

Board of Managers
Indiana Orthopaedic Hospital, LLC
Indianapolis, Indiana

We have audited the accompanying consolidated balance sheets of Indiana Orthopaedic Hospital, LLC (Hospital) as of December 31, 2011 and 2010, and the related consolidated statements of income, members' equity 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.

Except as discussed in the following paragraph, 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 accordance with the terms of our engagement, we did not audit the Hospital's investment in Southeast Surgery Center, LLC, a 50% owned affiliate, for which the investment is stated at $0 and $3,567,300 as of December 31, 2011 and 2010, respectively, and the equity in earnings for the years then ended is stated at $809,850 and $4,474,516, respectively, which is included in net income for the years then ended as described in Note 10 to the consolidated financial statements.

As discussed in Note 10 to the consolidated financial statements, the Hospital acquired OI South, LLC in a business combination on July 1, 2007. The Hospital recorded the acquisition at the historical carrying value of the assets acquired, which in our opinion, is not in accordance with accounting principles generally accepted in the United States of America. The effects of this matter on the consolidated financial statements are not reasonably determinable.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we performed the omitted auditing procedures described in the second preceding paragraph and of not accounting for the 2007 acquisition of OI South, LLC using the purchase method of accounting as discussed in the preceding paragraph, the consolidated financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of Indiana Orthopaedic Hospital, LLC as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, in 2011, the Hospital changed its method of presentation and disclosure of patient service revenue, provision for uncollectible accounts and the allowance for uncollectible accounts in accordance with Accounting Standards Update 2011-07.

BKD, LLP

March 7, 2012

Indiana Orthopaedic Hospital, LLC

Consolidated Balance Sheets

December 31, 2011 and 2010

Assets

	2011	2010
Current Assets		
Cash and cash equivalents	$ 14,930,943	$ 7,465,625
Patient accounts receivable, net of allowance: 2011 - $3,200,000, 2010 - $2,000,000	15,888,682	11,055,984
Due from affiliate	19,428	160,459
Supplies	1,097,323	877,508
Prepaid expenses and other	229,101	300,380
Total current assets	32,165,477	19,859,956
Property and Equipment, at cost		
Land and land improvements	4,171,823	4,171,823
Buildings and improvements	2,290,087	2,236,150
Equipment	24,244,322	24,483,785
	30,706,232	30,891,758
Less accumulated depreciation	16,554,474	16,474,503
	14,151,758	14,417,255
Other Assets		
Investment in affiliate	-	3,567,300
Other	71,400	71,410
	71,400	3,638,710
Total assets	$ 46,388,635	$ 37,915,921

Liabilities and Members' Equity

	2011	2010
Current Liabilities		
Accounts payable	$ 4,264,867	$ 2,541,616
Accrued expenses	3,114,483	2,526,233
Current maturities of long-term obligations	1,122,887	2,319,737
Total current liabilities	8,502,237	7,387,586
Long-Term Obligations	6,098,753	1,691,169
Total liabilities	14,600,990	9,078,755
Members' Equity	31,787,645	28,837,166
Total liabilities and members' equity	$ 46,388,635	$ 37,915,921

Indiana Orthopaedic Hospital, LLC

Consolidated Statements of Income

Years Ended December 31, 2011 and 2010

	2011	2010
Operating Revenues		
Net patient service revenue	$ 119,833,444	$ 99,366,336
Provision for uncollectible accounts	(1,718,552)	(1,738,325)
Net patient service revenue less provision for uncollebtible accounts	118,114,892	97,628,011
Other	554,680	675,770
Gain on sale of property	228,968	-
Total operating revenues	118,898,540	98,303,781
Expenses and Losses		
Salaries and wages	19,585,844	18,746,594
Employee benefits	3,713,188	4,357,744
Purchased services and professional fees	5,941,583	5,441,677
Medical supplies	25,039,380	23,487,081
Facility expense	11,399,730	9,417,686
Management fees	5,202,000	-
Depreciation and amortization	1,766,617	2,090,444
Interest	296,218	204,470
Other expenses	3,870,059	2,796,759
Total operating expenses	76,814,619	66,542,455
Operating Income	42,083,921	31,761,326
Other Income (Expense)		
Income from joint venture activities	809,850	4,474,516
Loss on joint venture divestiture	(1,491,168)	-
Investment return	8,163	1,678
Total other income (expense)	(673,155)	4,476,194
Net Income	$ 41,410,766	$ 36,237,520

Indiana Orthopaedic Hospital, LLC

Consolidated Statements of Members' Equity
Years Ended December 31, 2011 and 2010

Balance, January 1, 2010	$ 24,102,155
Net income	36,237,520
Membership units issued	544,000
Distributions to members	(32,046,509)
Balance, December 31, 2010	28,837,166
Net income	41,410,766
Membership units issued	1,024,000
Membership units redeemed	(44,957)
Distributions to members	(39,439,330)
Balance, December 31, 2011	$ 31,787,645

Indiana Orthopaedic Hospital, LLC
Consolidated Statements of Cash Flows
Years Ended December 31, 2011 and 2010

	2011	2010
Operating Activities		
Net income	$ 41,410,766	$ 36,237,520
Items not requiring (providing) cash		
Depreciation and amortization	1,766,617	2,090,444
Undistributed earnings of joint venture	-	525,965
Loss on write-off of joint venture	1,491,168	-
(Gain) loss on sale of property and equipment	(228,968)	24,455
Provision for uncollectible accounts	1,718,552	1,738,325
Changes in		
Patient accounts receivable, net	(6,551,250)	(2,795,734)
Estimated amounts due from and to third-party payers	-	(197,452)
Accounts payable and accrued expenses	2,452,532	(150,946)
Other current assets	1,927,606	161,064
Net cash provided by operating activities	43,987,023	37,633,641
Investing Activities		
Proceeds from sale of property and equipment	289,325	-
Purchase of property and equipment	(1,561,477)	(4,880,127)
Net cash used in investing activities	(1,272,152)	(4,880,127)
Financing Activities		
Net borrowings under a line-of-credit agreement	918,058	-
Proceeds from capital lease obligation	4,059,347	-
Principal payments under long-term obligations	(1,766,671)	(1,806,205)
Proceeds from issuance of membership units	1,024,000	544,000
Distributions to members	(39,439,330)	(32,046,509)
Unit redemption	(44,957)	-
Net cash used in financing activities	(35,249,553)	(33,308,714)
Increase (Decrease) in Cash and Cash Equivalents	7,465,318	(555,200)
Cash and Cash Equivalents, Beginning of Year	7,465,625	8,020,825
Cash and Cash Equivalents, End of Year	$ 14,930,943	$ 7,465,625
Supplemental Cash Flows Information		
Interest paid	$ 296,218	$ 204,470

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

Nature of Operations

Indiana Orthopaedic Hospital, LLC primarily earns revenues by providing inpatient and outpatient musculoskeletal and related surgical services to patients in the greater Indianapolis, Indiana area.

NNS, LLC was formed in 2008 in the state of Indiana for the purpose to own, manage, invest, develop, lease and otherwise deal in real property.

Principles of Consolidation

The consolidated financial statements include the accounts of Indiana Orthopaedic Hospital, LLC and NNS, LLC (collectively, "the Hospital"). All material inter-organization accounts 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2011 and 2010, cash equivalents consisted primarily of money market accounts.

Through December 31, 2012, deposits held in noninterest-bearing transaction accounts are fully insured, regardless of the amount in the account, at all FDIC-insured institutions. For interest-bearing cash accounts, the FDIC's insurance limits were permanently increased to $250,000, effective July 21, 2010. At December 31, 2011, the Hospital did not have any balances in interest-bearing cash accounts exceeding federally insured limits.

Investment Return

Investment return is comprised primarily of interest income earned on the operating cash accounts.

Change in Accounting Principle

In 2011, the Hospital changed its method of presentation and disclosure of patient service revenue, provision for bad debts and the allowance for doubtful accounts in accordance with Accounting Standards Update (ASU) 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The major changes associated with ASU 2011-07 are to reclassify the provision for uncollectible accounts related to patient service revenue to a deduction from patient service revenue and to provide enhanced disclosures around the Medical Center's policies related to uncollectible accounts. The change had no effect on prior year change in net assets.

Total operating expenses were previously reported in 2010 as $68,280,780 and total operating revenues were previously reported as $100,042,106. Both 2010 previously reported values were reduced by the provision for uncollectible accounts of $1,738,325.

Patient Accounts Receivable

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Hospital records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated or provided by policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Hospital's allowance for doubtful accounts for self-pay patients increased from 66% of self-pay accounts receivable at December 31, 2010, to 76% of self-pay accounts receivable at December 31, 2011. In addition, the Hospital's write-offs increased approximately $153,459 from approximately $121,348 for the year ended December 31, 2010, to approximately $274,807 for the year ended December 31, 2011. Both increases were the result of negative trends experienced in the collection of amounts from self-pay patients in fiscal year 2011.

Supplies

The Hospital states supply inventories at the lower of cost, determined using the first-in, first-out (FIFO) method or market.

Property and Equipment

Property and equipment 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.

Investment in Affiliate

Effective July 1, 2007, the Hospital entered into a joint venture agreement with an Indianapolis health care provider to jointly operate Southeast Surgery Center, LLC (d/b/a Indiana Orthopaedic Surgery Center), an ambulatory surgery center on the south side of Indianapolis. The Hospital's investment in this joint venture is accounted for under the equity method of accounting with the associated earnings reported as other income in the accompanying operating statement.

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 and includes estimated retroactive revenue adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such estimated amounts are revised in future periods as adjustments become known.

Substantially all of the net patient service revenue received by the Hospital is from third-party payer sources.

Charity Care

The Hospital provides charity care to patients who are unable to pay for services. The amount of charity care is included in net patient service revenue and is not separately classified from the provision for uncollectible accounts.

Estimated Malpractice Costs

Estimated malpractice costs, if any, include estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Income Taxes

The Hospital is organized as a pass-through Limited Liability Company under the Internal Revenue Code. As such, the Hospital is not taxed at the entity level, and income is passed through to the members of the Hospital at the individual level. Accordingly, the Hospital does not recognize income taxes in the accompanying consolidated financial statements. The Hospital's tax years still subject to examination by taxing authorities are years subsequent to December 31, 2008.

Subsequent Events

Subsequent events have been evaluated through the date of the Independent Accountants' Report, which is the date the consolidated financial statements were available to be issued.

Note 2: Net Patient Service Revenue

The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for bad debts related to uninsured patients in the period the services are provided. This provision for bad debts is presented on the consolidated statement of income as a component of 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 rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Medicaid. Inpatient acute care services and substantially all outpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital has also 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 34% and 24% of the Hospital's receivables are due from a single commercial insurance carrier for the years ended December 31, 2011 and 2010, respectively.

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the year ended December 31, was approximately:

	2011	2010
Medicare	$ 958,088	$ 1,400,760
Medicaid	33,385,838	27,457,721
Other third-party payers and self-pay	85,489,518	70,507,855
Total	$ 119,833,444	$ 99,366,336

Note 3: Limited Liability Company

The Hospital is organized as an Indiana limited liability company and is governed by a five-member board of managers. The board of managers is generally responsible for the direction and management of the Hospital. The Hospital is owned by four classes of units and members, referred to as Classes A, B, C and D. At the time a Class A, B or C member disassociates from the Hospital, the units will be purchased by the Hospital for a purchase price defined in the operating agreement.

Class A members control a total of 12,048 and 10,669 units at December 31, 2011 and 2010, respectively, and generally receive a pro-rata percentage of operating profits from the Hospital as defined in the operating agreement. Class A members' voting responsibilities include the election of members to serve on the board of managers. They vote on all matters subject to a membership vote and also retain certain reserved powers. The reserved powers limit certain decisions that can only be decided by Class A members and also limit when Class B members can vote on general membership voting matters. Total members' equity of Class A units approximates $24,642,150 and $21,517,730 at December 31, 2011 and 2010, respectively.

Class B members control a total of 569 units at December 31, 2011 and 2010 and generally receive a pro-rata percentage of operating profits from the Hospital, with certain limitations, as defined in the operating agreement. Their units allow them to vote on matters submitted to the membership; however, the Class A members reserved powers may limit the ability for Class B members to vote on certain matters. Total members' equity of Class B units approximated $787,966 and $1,091,468 at December 31, 2011 and 2010, respectively.

Class C members control 240 units at December 31, 2010 and receive profit distributions based upon its pro-rata share of profits earned from the Hospital's interest in the Southeast Surgery Center, LLC. Class C units are nonvoting units. Total members' equity of Class C units approximated $460,535 at December 31, 2010. Effective March 15, 2011, the joint venture agreement between the Hospital and the Southeast Surgery Center, LLC was terminated, and all Class C units were redeemed.

During 2009, the Hospital amended and restated its operating agreement to permit a Class D member. The Class D member owns a 20% interest in the Hospital, including all economic attributes and assets owned and utilized by the Hospital. The Class D member is entitled to a single vote equal to 20% interest in all of the Hospital's issues other than issues related to the issuance or redemption of Class A units or issues pertaining specifically to Southeast Surgery Center, LLC and/or the South Campus (as described in Note 11). The Class D member shares in a pro-rata share of the profits or losses of the Hospital except for those profits and losses attributed to the Southeast Surgery Center, LLC and/or the South Campus. Total members' equity of Class D units approximated $6,357,529 and $5,767,433 at December 31, 2011 and 2010, respectively. Under the terms of the Class D units, for any reason, the Class D member may elect to require the Hospital to purchase the Class D units. Additionally, voting Class A members may elect to call the outstanding units. Such transactions will be based upon the then fair market value, as defined in the operating agreement.

NNS, LLC (Company) was organized as a limited liability company and was formed in October 2008. Indiana Orthopaedic Hospital, LLC is the sole member of NNS, LLC with complete authority, power and discretion to manage and control the business affairs and properties of the Company, to make all decisions regarding those matters and to perform any and all other acts or activities customary or incident to the management of NNS, LLC's business. The Hospital holds 100 units of the Company.

Note 4: Medical Malpractice Coverage and Claims

Medical Malpractice Claims

The Hospital is a qualified health care provider under the Indiana Medical Malpractice Act and is fully insured under a claims-made policy on a fixed premium basis. The Indiana Medical Malpractice Act limits a qualified provider's liability for an occurrence to the amount of required insurance. The Indiana patient compensation fund is liable for the excess up to an overall damage cap. 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. Based upon the Hospital's claim experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 5: Line of Credit

The Hospital is a party to a line of credit and equipment purchase line agreements with a bank providing up to $5,000,000 and $2,000,000 in borrowings, respectively. The line of credit agreement expires August 5, 2012, and the equipment purchase line expires August 5, 2017. At December 31, 2011 and 2010, no balance had been drawn on the line of credit. At December 31, 2011, $918,058 was drawn on the equipment purchase line. The equipment purchase line is set to convert into a note payable in 2012, which is more fully described in Note 6.

Note 6: Long-Term Obligations

	2011	2010
Capital lease obligations (A)	$ 3,403,728	$ 212,730
Note payable to bank (B)	1,287,925	2,104,243
Note payable to bank (C)	1,611,929	1,693,933
Capital expenditure line of credit (D)	918,058	-
Total long-term obligations	7,221,640	4,010,906
Less current maturities	1,122,887	2,319,737
	$ 6,098,753	$ 1,691,169

(A) Two capital lease obligations exist at December 31, 2011, payable in monthly installments of $73,393 with an interest rate of 3.25% and $11,274 with an interest rate of 3.5%. The leases are governed by a master lease agreement from a leasing company and are secured by the leased equipment. One lease is set to expire in 2016 and the other in 2012.

(B) A promissory note in the name of NNS, LLC, originally due July 20, 2011, was amended during 2011 to extend the maturity date to July 25, 2016; payable in monthly installments of $8,432 with a balloon payment due at maturity. The interest rate is fixed at 4.75%. The loan is secured by certain real estate.

(C) Due January 10, 2025; a promissory note in the name of NNS, LLC, payable in monthly installments of $14,427 plus variable rate interest based on a five-year treasury index plus 3%. At December 31, 2011, this rate was 5.5%. The loan is secured by certain real estate.

(D) Equipment purchase line which is scheduled to convert into a promissory note in 2012, payable in 60 monthly installments of $15,301 plus variable rate interest of prime plus one-half percent. At December 31, 2011, this rate was 3.75%. The loan is secured by the Hospital's assets.

Property and equipment include the following property under capital lease arrangements:

	2011	2010
Equipment	$ 3,985,283	$ -
Less accumulated depreciation	489,725	-
	$ 3,495,558	$ -

Aggregate annual payments on capital lease obligations and long-term debt at December 31, 2011, are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2012	$ 295,830	$ 926,190
2013	318,003	880,716
2014	325,247	880,716
2015	332,883	880,716
2016	1,403,540	68,873
Thereafter	1,142,409	-
	$ 3,817,912	3,637,211
Less amount representing interest		233,483
Present value of future minimum lease payments		3,403,728
Less current maturities		827,057
Noncurrent portion		$ 2,576,671

Note 7: Operating Leases

Noncancellable operating leases for the primary Hospital facility, several other facilities in the greater Indianapolis area and certain diagnostic equipment expire through 2025. The facility leases generally contain renewal options for periods ranging from five to ten years and require the Hospital to pay all executory costs (property taxes, maintenance and insurance). The leases are secured by certain assets, as defined in the lease agreements.

Future minimum lease payments at December 31, 2011, were:

2012	$ 7,709,781
2013	7,787,680
2014	7,922,714
2015	7,717,171
2016	4,992,082
Later years	21,587,230
Future minimum lease payments	$ 57,716,658

Total lease expense was $7,673,509 and $7,667,153 for 2011 and 2010, respectively.

Note 8: Related Party Transactions

The Hospital and Orthopaedics-Indianapolis, P.C. (Ortho Indy) are related parties through common ownership. Ortho Indy provides certain management, administrative and payroll related services for the Hospital. Reimbursed expenses to Ortho Indy amounted to $2,618,394 and $5,935,174 for the years ended December 31, 2011 and 2010, respectively. Reimbursed expenses from Ortho Indy amounted to $1,351,669 and $848,519 for the years ended December 31, 2011 and 2010. Amounts due from and to Ortho Indy are reported in the accompanying consolidated balance sheets as due from and to affiliates.

Effective January 1, 2011, the Hospital entered into a management service agreement with OrthoIndy Enterprises, LLC (OE) to provide management services, including certain management, administrative and payroll related services for an initial period of five years, renewing automatically for one year terms unless terminated by either party. OE is a related party through common ownership. Total payments to OE for 2011 amounted to $5,287,562. Reimbursed expenses from OE for 2011 amounted to $126,181.

The Hospital subleases certain facilities from Ortho Indy on the west and south sides of Indianapolis. The west and south side leases expire in 2023 and 2025, respectively, and provide annual rental payments of approximately $2,270,000. Lease expense recognized in 2011 approximated $2,270,000.

The base annual rentals for the facilities for the west and south side leases were $32.55 and $37.51 per square foot, respectively, subject to certain yearly increases as identified in the subleases. Future minimum lease payments are included in Note 7.

During 2009, NNS, LLC, a consolidated entity of the Hospital, acquired certain property for $2,350,000. The Hospital rents the use of the property from NNS, LLC. The intercompany rent has been eliminated in the consolidated financial statements.

Note 9: Pension Plans

In March 2007, the Hospital joined the postretirement benefit plan of Ortho Indy. The plan provides for a matching component for up to 6% of the employees' salary and also allows a discretionary profit-sharing contribution from the Hospital. Substantially all of the Hospital's full-time employees are covered by the plan. Pension expense in 2011 and 2010 was $1,050,129 and $985,633, respectively.

Note 10: Investment in Affiliate

The investment in affiliate relates to a 50% ownership of the Southeast Surgery Center, LLC (SSC). The Hospital acquired an ownership in this entity on July 1, 2007. In December 2009, a complaint was filed citing that certain Hospital members breached their fiduciary responsibility in regards to their 50% ownership in SSC. In 2011, a settlement agreement was signed indicating dissolution of SSC. Effective March 15, 2011, the joint venture agreement was terminated and the investment balance was written down to zero. The loss recognized on the write-off of the investment for 2011 was $1,491,168. Financial position and results of operations of the investee at December 31 are summarized below:

	2011 (Unaudited)	2010 (Unaudited)
Current assets	$ -	$ 6,993,936
Property and other long-term assets, net	-	332,424
Total assets	$ -	$ 7,326,360
Accounts payable and accrued liabilities	$ -	$ 191,760
Members' equity	-	7,134,600
Total liabilities and members' equity	$ -	$ 7,326,360
Revenues	$ 7,127,915	$ 15,824,375
Net income	5,370,715	8,949,033

On July 1, 2007, the Hospital acquired the assets of OI South, LLC in a business combination. OI South, LLC owned a 50% interest in the Southeast Surgery Center, LLC. The acquisition met the definition of a business combination under Financial Accounting Standards Board Statement No. 141 (FAS 141), *Business Combinations*, which was subsequently incorporated into the FASB Accounting Standards Codification (ASC) Topic 805. ASC 805 requires the acquisition to be accounted for under the purchase method of accounting. Although the business combination was supported and accomplished by fair market value calculations, management elected to record the investment at the book value of the net assets received which is not in compliance with this standard. The Hospital issued approximately $1,343,000 of various classes of membership units in exchange for the outstanding member units of OI South, LLC. The Hospital's interest in the operations of Southeast Surgery Center, LLC is accounted for under the equity method of accounting subsequent to the business combination.

Note 11: Commitments and Contingencies

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. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Self Insurance of Employee Health Claims

The Hospital pools its share of health insurance claims with Ortho Indy, a related party. Any such accrual is included in the related party accrual described in Note 8.

Note 12: 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 Notes 1 and 4.

Admitting Physicians

The Hospital is served by a group of admitting and surgical physicians that comprise nearly 100% of the Hospital's net patient service revenue. The physician group is a related party of the Hospital through common ownership as described in Note 8.

Economic and Political Conditions

The current protracted economic decline continues to present hospitals with difficult circumstances and challenges, which in some cases have resulted in unanticipated declines in volumes, constraints on liquidity and difficulty obtaining financing. The consolidated 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 the Hospital's 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 consolidated financial statements could change rapidly, resulting in material future adjustments in allowances for accounts receivable or other financial statement elements.

In recent years, The United States Congress has passed legislation that affects new or expanding physician-owned specialty hospitals. In between legislative actions, Congress and the Centers for Medicare and Medicaid Services continue discussion about how legislation may affect specialty hospitals, ranging from disclosures to prohibition of new specialty hospitals. Most recently, The Affordable Care Act of 2010 contained provisions limiting the expansion of existing specialty hospitals. Management believes they are in compliance with all current laws and regulations. However, management can not estimate the long-term impact of any future legislation on the Hospital given the uncertainty involved with the regulatory changes.