

TIPTON COUNTY MEMORIAL HOSPITAL

COMBINED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2007 AND 2006

CPAs / ADVISORS



TIPTON COUNTY MEMORIAL HOSPITAL

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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 Trustees
Tipton County Memorial Hospital
Tipton, Indiana

We have audited the accompanying combined balance sheets of Tipton County Memorial Hospital (the Hospital), as of December 31, 2007 and 2006 and the related combined statements of operations and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above, present fairly, in all material respects, the combined financial position of the Hospital as of December 31, 2007 and 2006, and the 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.

Management's discussion and analysis, on pages i through x, is not a required part of the basic combined financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Blue & Co., LLC

April 15, 2008

REQUIRED SUPPLEMENTARY INFORMATION

TIPTON COUNTY MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

Tipton County Memorial Hospital's (the Hospital) annual combined financial statement presents background information and management's discussion and analysis of the Hospital's financial performance during the year ended December 31, 2007.

This section includes a discussion and analysis of activities as results of the Hospital operations. Hospital facilities include: Tipton County Memorial Hospital, a 25 bed (25 bed acute care, Medical/Surgical/ICU) unit, Autumnwood Village a 40 unit assisted living facility and The Tipton County Memorial Hospital Foundation. All facilities are located in Tipton, Indiana and serve Tipton County and the surrounding counties in north central Indiana.

In 2007, the Hospital experienced 6,513 acute care patient days and 45,265 outpatient visits.

The Hospital bases its priorities and sets performance goals based on its Mission Statement, Core Strategies, and Key Financial Indicators.

MISSION STATEMENT

The Hospital is dedicated to being the community based center of high quality, compassionate health services and education to all citizens of Tipton County and neighboring areas, in a financially responsible manner.

CORE STRATEGIES

The Hospital has identified the following core strategies in a continued effort to fulfill our mission:

- Striving to become the regional benchmark for demonstrated outcomes,
- Service excellence,
- Cost effectiveness,
- Expanding and solidifying relationship with physicians,
- Working toward the goals of increasing primary care base/system entry points throughout the region and strengthening and differentiating select clinical services,
- To serve as the leader for a community-based approach to promote improved services health status while continuing a management agreement with Clarian Health Partners and applying best practices,

TIPTON COUNTY MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

- The Hospital also strives to manage both human and material resources to assure sound economies of operations, optimum employment practices, and a reasonable return on investment.

The Hospital's goals are measured by set success indicators, which help assure accountability in providing the best practice and demonstrate quality outcomes for patients.

FINANCIAL INDICATORS - PERFORMANCE

The Hospital strives to offer quality, compassionate, and advanced medical care as indicated in the above performance measures, and works to balance those objectives with sound financial performance.

The accompanying hospital financial report consists of three statements – a Balance Sheet, Statement of Operations and Changes in Net Assets, and a Statement of Cash Flows. These reports should be reviewed in conjunction with the following discussion and analysis.

Selected Financial and Statistical Data, for the Year Ended December 31, 2007, is shown on the following page and the Management's Discussion and Analysis (MD & A) should be reviewed together with the financial statements included with this report.

FINANCIAL HIGHLIGHTS

During 2007, the Hospital made capital acquisitions and operational improvements as follows:

- January: Hospital receives the American Heart Association's Get with the Guidelines – Heart Failure Initial Achievement Award
- February: Construction steel begins to go up on the \$18.4 million Expansion Project (new Registration, Emergency Department and Radiology)
- March: Tipton Hospital Laboratory was awarded an accreditation by the Commission on Laboratory Accreditation of the College of American Pathologist.
- April: Autumnwood Village announces Sherri Dawson as Community Relations Director
- May: Tipton Hospital during National Hospital Week presented service awards to 50 associates.
- June: Tipton Hospital offers improvements in Behavior Health Services, by announcing that Howard Regional Health System will take over Behavior Health Services in Tipton.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

- June: Tipton Hospital announces the opening of the Rehabilitative & Orthopedic Centers of Indiana (ROC), complete head to toe orthopedic care in Indiana, Dr. Martin Deafenbaugh, Medical Director.
- July: Tipton Hospital announces that Dr. Charles Lai, M.D. is Medical Director of Emergency Services
- July: Tipton Hospital announces that the Rehabilitative & Orthopedic Center also includes the New Balance Clinic, where Dr. Jon Finley, is the Medical Director
- August: Tipton Hospital welcomes Dr. Kevin Condict; M.D. Orthopedic Surgeon who joins Dr. Deafenbaugh in the ROC.
- September: The New North Parking lot was open for Patients and Associates parking
- September: Tipton Hospital Foundation has a Barn Dance/Auction as a fundraiser at the Kelly's Round Barn
- October: Tipton Hospital (along with 277 hospitals in the U.S.) recognized in the July 23 issue of the US News & World Report by the American Heart Association/American Stroke Association's Get with the Guidelines SM (GWTG) program. This is a quality improvement program to insure Patient consistently receives cardiac and stroke care within the guidelines.
- October: Tipton Hospital honors U.S. Service Men and Women by sending packages for individuals for Christmas.
- November: Tipton Hospital announces that they have entered into a Letter of Intent (LOI) with Clarian Health Partners to strengthen the affiliation agreement.
- December: Tipton Hospital announces that Millers Health System will lease Autumnwood Village from Tipton Hospital Foundation, effective January 1, 2008.

USING THIS ANNUAL REPORT

The Hospital's annual combined financial reports consist of three statements – a Balance Sheet, a Statement of Operations and Changes in Net Assets, and a Statement of Cash Flows. These combined financial statements and related notes provide information regarding the Hospital activities, including resources that are restricted for specific purposes by contributors, grantors, and other third parties.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2007 AND 2006

THE BALANCE SHEET AND THE STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS

The analysis of Hospital finances begins herein. One of the most important questions asked about the Hospital's financial position is, "Is the Hospital better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Operations and Changes in Net Assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report changes in the Hospital's net assets. A net asset – the difference between assets and liabilities – is one measure of the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in the Hospital's patient volume and quality measures and other economic factors need to be considered when assessing the overall health of the Hospital.

THE STATEMENT OF CASH FLOWS

The final required statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and the net changes in cash resulting from operations, investing and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?", and "What was the change in cash balance during the reporting period?".

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

THE HOSPITAL'S NET ASSETS

The Hospital's net assets are the difference between its assets and liabilities reported on the Balance Sheet on page 3. The Hospital's net assets increased over the past year by \$1,757,020 or 7.6% in 2007. In 2006, net assets increased by \$1,021,553 or 4.6%. The Hospital's net assets are detailed in the following table:

	<u>2007</u>	<u>2006</u>
ASSETS		
Current assets	\$ 10,453,145	\$ 8,530,839
Capital assets, net	27,143,893	16,991,647
Other noncurrent assets	18,830,445	28,074,169
Total assets	<u>\$ 56,427,483</u>	<u>\$ 53,596,655</u>
LIABILITIES		
Long-term debt outstanding	\$ 26,290,500	\$ 26,914,517
Other current and noncurrent liabilities	5,187,451	3,489,626
Total liabilities	<u>\$ 31,477,951</u>	<u>\$ 30,404,143</u>
NET ASSETS		
Invested in capital assets, net of related debt	\$ 8,642,286	\$ 7,664,676
Restricted - expendable - funded depreciation and debt service	10,434,125	9,787,306
Unrestricted	5,873,121	5,740,530
Total net assets	<u>\$ 24,949,532</u>	<u>\$ 23,192,512</u>

Certain significant changes in the Hospital's assets included the increase in capital assets as a result of the construction in progress of \$12,409,224 as part of the existing building program. The Hospital also saw a decrease in non-current assets of \$9,243,724, which represents the funds from the 2006 bond issue, payments made as work is completed. The Hospital's liabilities increased \$1,073,808 as a result of the increase in outstanding equipment purchases at year end (pending opening of new project in January 2008) and the increase in the Bond Swap (derivative liability).

TIPTON COUNTY MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

OPERATING RESULTS AND CHANGES IN THE HOSPITAL'S NET ASSETS

In 2007, the Hospital's net assets increased by \$1,757,020 as shown in the next table. This increase is made up of various different components, and will be further explained as operating results and changes in net assets are discussed.

Operating Income

The summary component of overall changes in the Hospital's net assets is its operating income – generally, the difference between net patient services revenue plus the other operating revenue minus the expenses incurred to perform those services. During 2007, the Hospital had an operating gain of \$1,385,871 compared to \$1,328,459 in 2006; (note 2006 has been reclassified to show a discontinued operation (loss) of \$(768,751) on a separate line below operating income from continuing operations. In 2007, the Hospital saw the operating revenue (net patient revenue plus other operating revenue) increase \$1,511,704 or 4.5% over the 2006 level. The Hospital saw gross inpatient revenues (charges) increase (\$1,067,064) or 6.7% over 2006, as well as gross outpatient revenues (charges) increase by \$2,982,842 or 7.6% in 2006, more than the 2006 year. Many departments saw increases in activity in 2007 and a few saw decreases in 2007. The Hospital had 87 or 1.4% more acute care patient days (Med/Surg, and ICU) in 2007 compared to 2006; or, 17.8 patients per day in 2007, compared to 17.6 patients per day in 2006. With the increase in total days (Acute Care) of 87, more supplies, food and drugs were used to care for these patients. On the outpatient side of the business, we saw increased charges in Operating Room/GI Lab, MRI, CT Scans, Nuclear Medicine, Ultrasound, Radiology, Lab, Emergency Department, Rehab Services, Oncology, and the (in house) Sleep Lab Program.

The contractual allowance increased by \$3,197,697, which was 41.3% of gross revenue for 2007, compared to 38.5% in 2006. The contractual allowance is the difference between hospital charges, and what is paid by Medicare, Medicaid, and other third party payors (such as Blue Cross, Sagamore, Aetna, etc.). The Medicare and Medicaid programs set the rates for reimbursement to hospitals and other healthcare providers; in contrast the Hospital negotiates the various contracts with the other third parties – Managed Care Agreements. The Hospital had bad debts of \$1,411,188 or 2.4% of gross revenue compared to \$1,719,286 or 3.1% of gross revenue in 2006. The Hospital's charity care (for 2007 was \$878,776) increased \$383,878 or 77.6% over the 2006 level.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
Operating revenues		
Net patient service revenue	\$ 32,348,294	\$ 31,571,865
Other operating revenue	2,521,801	1,786,526
Total operating revenue	<u>34,870,095</u>	<u>33,358,391</u>
Operating expenses		
Salaries and benefits	18,432,118	17,035,771
Medical supplies and drugs	4,412,551	4,368,760
Depreciation and amortization	1,725,792	1,725,380
Other operating expenses	8,913,763	8,900,021
Total operating expenses	<u>33,484,224</u>	<u>32,029,932</u>
Operating income from continuing operations	1,385,871	1,328,459
Nonoperating income (expenses)		
Investment income	952,927	985,417
Interest expense	(15,493)	(177,725)
Other	-0-	22,211
Unrealized loss on interest rate swap	(279,010)	(364,577)
Payments related to the agency agreement	(198,403)	(3,481)
Total nonoperating income (expenses)	<u>460,021</u>	<u>461,845</u>
Change in net assets before discontinued operations	1,845,892	1,790,304
Loss from operations of discontinued components	<u>(88,872)</u>	<u>(768,751)</u>
Changes in net assets	<u>\$ 1,757,020</u>	<u>\$ 1,021,553</u>

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

The Hospital's mix of receivables is as follows:	<u>2007</u>	<u>2006</u>
Medicare	36%	33%
Medicaid	4%	8%
Blue Cross	17%	13%
Commercial	25%	25%
Self-pay	18%	21%
Total	<u>100%</u>	<u>100%</u>

The Hospital's net patient service revenue increased \$776,429 or 2.4% in 2007, compared to 2006.

The Hospital's operating expenses increased by \$1,454,292 or 4.5% over 2006.

The increase in inpatient days and with a decrease in outpatient visits, and little change in surgeries over 2006, had minimal effect on supplies and drugs in most areas. The salaries and benefits increased \$1,396,347 or 8.2% over 2006 levels; with approximately 3% to maintain competitive wage rates; the employment of physicians to cover the Emergency Department, OB/GYN office practice and Pediatric office practice; the increase in health insurance cost for associates, as well as increase in employer incentive matching (limit 1%) of the 403B benefit. The Hospital is no different from other employers in that we have increasing health care cost. We find associates are experiencing the costs being passed on to them. The employers can no longer covers the increased cost without sharing that burden with the users of the insurance; they are starting wellness programs and educating their work force on taking some responsibility for your own health.

NON-OPERATING INCOME, CONTRIBUTION, AND ENDOWMENTS

Non-operating income consists of investment income of \$952,927 and donations from the Tipton County Memorial Hospital Auxiliary of hours worked only; they saved their proceeds to donate the new player piano (December, 2007) in the South Lobby. The Hospital also receives a semi annual interest income distribution, which is included in the investment income from the Lebo Endowment (managed by the Tipton County Foundation/Harris Bank). Also, starting in 2004, the interest expense is reported under Non-operating Income (expense) and was \$(15,493) in 2007 compared to \$(177,725) in 2006. See the Debt Section under this report for further discussion regarding interest expense.

TIPTON COUNTY MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

THE HOSPITAL'S CASH FLOW

The Hospital's cash flow decreased throughout the 2007 period, as the Medicare per diem rate for the acute care side of the Hospital saw little change, even though the Hospital patient accounting staff continued to gain efficiency in the billing and collection process with the current computer system. The net change in cash was a decrease of \$47,598 in 2007 compared with a decrease of \$2,311,701 in 2006. The decrease in cash position is a result of the acquisition and construction of capital assets, even though the Hospital's days of revenue in accounts receivable at 53 days, is well below the State average of around 55 - 60 days for a similar sized hospital.

CAPITAL ASSET AND DEBT ADMINISTRATION

At the end of 2007, the Hospital had \$27,143,893 invested in capital assets, net of accumulated depreciation, as shown in a previous table and detailed in Note 8 to the financial statements, compared to \$16,991,647 in 2006. In 2007, the Hospital purchased new equipment totaling \$1,394,821 of which most was used to replace small minor equipment that was fully depreciated and need replacement due to technology replacement. During 2007, the Hospital disposed of equipment of \$908,869, which was fully depreciated. Those items disposed of were throughout the Hospital and had little net book value. The Hospital also increase building value with the addition of the storage building in Tipton, as well as spending \$10,258,913 on construction in progress for the 2006 Expansion Project including (architect and construction costs) which started in the spring of 2006.

In the future the Hospital believes it is more economical in certain cases to lease certain high-cost clinical and diagnostic equipment than to purchase. Leasing spreads the cost over a 48 or 60 month time period, when many times the equipment may only have a four or five year expected life, due to advances in technology changes/enhancements, and allow the hospital to remain current with the changing technology.

DEBT

At year end, the Hospital had \$27,090,028 in long term debt, consisting of 2006 Series A (Tax Free) Bonds of \$24,200,000, 2006 Series B (Taxable) Bonds of \$2,590,000, backed by a letter of credit from Fifth Third Bank (to provide credit enhancement and liquid support for both 2006 issues). The Hospital also has a capital lease (Trane Co. – Chiller Lease and Vitros (Lab) Lease with Leasing Associates of Barrington). The Hospital defeased the 1997 Series A and B Bonds and the 2002 Series Bonds, in June 2006.

TIPTON COUNTY MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

OTHER ECONOMIC FACTORS

The Hospital sees little changes in the primary service area (county population is expected to remain static over the next few years). However, the Hospital must continue to increase its market share in the Tipton service area, provide high quality care, in a sound fiscal manner to maintain positive financial results. Currently, the Hospital is the second largest employer in the county with 303 paid FTE's (full time equivalent) at year end.

CONTACTING THE HOSPITAL'S FINANCIAL MANAGEMENT

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional information, contact the Hospital's Financial Management, at Tipton County Memorial Hospital, 1000 S. Main St., Tipton, IN 46072, Michael Harlowe, President and CEO, Vernon Schmaltz, VP – Finance/CFO.

TIPTON COUNTY MEMORIAL HOSPITAL

COMBINED BALANCE SHEETS DECEMBER 31, 2007 AND 2006

	2007	2006
ASSETS		
Current assets		
Cash and cash equivalents	\$ 2,694,433	\$ 2,639,646
Assets limited as to use	808,737	118,018
Patient accounts receivable, net of allowance for doubtful accounts of \$780,468 and \$1,299,653 for 2007 and 2006, respectively	4,701,155	4,188,344
Other receivables	241,300	138,106
Estimated third-party settlements	616,241	86,223
Supplies and other current assets	1,391,279	1,360,502
Total current assets	<u>10,453,145</u>	<u>8,530,839</u>
Assets limited as to use		
Board designated	10,434,125	9,787,306
Funds held by trustee	8,588,421	17,696,355
Total assets limited as to use	<u>19,022,546</u>	<u>27,483,661</u>
Assets limited as to use for current obligations	<u>(808,737)</u>	<u>(118,018)</u>
Noncurrent assets limited as to use	18,213,809	27,365,643
Capital assets, net	27,143,893	16,991,647
Other assets	<u>616,636</u>	<u>708,526</u>
Total assets	<u><u>\$ 56,427,483</u></u>	<u><u>\$ 53,596,655</u></u>

See accompanying notes to combined financial statements.

TIPTON COUNTY MEMORIAL HOSPITAL

COMBINED BALANCE SHEETS
DECEMBER 31, 2007 AND 2006

LIABILITIES AND NET ASSETS

	<u>2007</u>	<u>2006</u>
Current liabilities		
Current portion of long-term debt	\$ 799,528	\$ 108,809
Accounts payable and accrued expenses	1,421,730	913,304
Accrued payroll and related liabilities	2,041,120	1,705,019
Other current liabilities	150,619	195,400
Total current liabilities	<u>4,412,997</u>	<u>2,922,532</u>
Long-term liabilities		
Interest rate swap liability	643,587	364,577
Other long-term liabilities	130,867	202,517
Capital lease obligations	243,779	212,005
Revenue bonds payable	26,046,721	26,702,512
Total long-term liabilities	<u>27,064,954</u>	<u>27,481,611</u>
 Total liabilities	 31,477,951	 30,404,143
Net assets		
Invested in capital assets net of related debt	8,642,286	7,664,676
Restricted		
Expendable - board designated	10,434,125	9,787,306
Unrestricted	5,873,121	5,740,530
Total net assets	<u>24,949,532</u>	<u>23,192,512</u>
 Total liabilities and net assets	 <u>\$ 56,427,483</u>	 <u>\$ 53,596,655</u>

See accompanying notes to combined financial statements.

TIPTON COUNTY MEMORIAL HOSPITAL

COMBINED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
Operating revenue		
Net patient service revenue	\$ 32,348,294	\$ 31,571,865
Other	<u>2,521,801</u>	<u>1,786,526</u>
Total operating revenue	34,870,095	33,358,391
Operating expenses		
Salaries and benefits	18,432,118	17,035,771
Medical professional fees	285,075	335,625
Other professional fees	3,235,627	3,352,197
Medical supplies and drugs	4,412,551	4,368,760
Other supplies	1,032,766	1,138,878
Depreciation and amortization	1,725,792	1,725,380
Insurance	539,574	504,663
Other	<u>3,820,721</u>	<u>3,568,658</u>
Total operating expenses	<u>33,484,224</u>	<u>32,029,932</u>
Operating income from continuing operations	1,385,871	1,328,459
Nonoperating income (expense)		
Investment income	952,927	985,417
Interest expense	(15,493)	(177,725)
Other	-0-	22,211
Unrealized loss on interest rate swap	(279,010)	(364,577)
Payment related to the agency agreement	<u>(198,403)</u>	<u>(3,481)</u>
Total nonoperating income	<u>460,021</u>	<u>461,845</u>
Change in net assets before discontinued operations	1,845,892	1,790,304
Loss from operations of discontinued components	<u>(88,872)</u>	<u>(768,751)</u>
Change in net assets	1,757,020	1,021,553
Net assets, beginning of year	<u>23,192,512</u>	<u>22,170,959</u>
Net assets, end of year	<u><u>\$ 24,949,532</u></u>	<u><u>\$ 23,192,512</u></u>

See accompanying notes to combined financial statements.

TIPTON COUNTY MEMORIAL HOSPITAL

COMBINED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
Operating activities		
Cash received from patient services	\$ 31,934,511	\$ 33,589,824
Cash paid to/from employees	(18,164,576)	(19,227,057)
Cash paid to vendors and suppliers	(13,645,999)	(15,510,724)
Other receipts, net	2,516,046	1,798,899
Net cash flows from operating activities	2,639,982	650,942
Noncapital financing activities		
Other nonoperating	-0-	22,211
Capital and related financing activities		
Acquisition and construction of capital assets	(11,679,385)	(3,701,439)
Proceeds from sale of capital assets	18,751	-0-
Interest on long term debt	(15,493)	(177,725)
Proceeds from long term debt	-0-	26,688,698
Principal paid on long term debt	(124,707)	(6,642,129)
Payment related to the agency agreement	(198,403)	(3,481)
Net cash flows from capital and related financing activities	(11,999,237)	16,163,924
Investing activities		
Other assets and liabilities	-0-	(468,012)
Investment income	952,927	985,417
Net change from other investing activities	8,358,730	(19,666,183)
Net cash flows from investing activities	9,311,657	(19,148,778)
Net change in cash and cash equivalents	(47,598)	(2,311,701)
Cash and cash equivalents, beginning of year	3,294,704	5,606,405
Cash and cash equivalents, end of year	\$ 3,247,106	\$ 3,294,704
Reconciliation of cash and cash equivalents		
Cash and cash equivalents in current assets	\$ 2,694,433	\$ 2,639,646
Cash and cash equivalents in assets limited as to use		
Board designated	517,721	47,593
Held by Trustee	34,952	607,465
Total cash and cash equivalents	\$ 3,247,106	\$ 3,294,704

See accompanying notes to combined financial statements.

TIPTON COUNTY MEMORIAL HOSPITAL

COMBINED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
Reconciliation of operating income to cash flows from operating activities		
Operating income	\$ 1,385,871	\$ 1,328,459
Adjustments to reconcile operating income to net cash flows operating activities		
Depreciation and amortization	1,725,792	1,725,380
Provision for bad debts	1,411,188	1,719,286
(Gain) loss on disposal of property	(5,755)	12,373
Results from discontinued operations	(88,872)	(768,751)
Changes in operating assets and liabilities		
Patient accounts receivable	(1,923,999)	(1,889,059)
Other current assets	(178,752)	(219,855)
Estimated third-party settlements	(530,018)	(876,413)
Accounts payable and accrued expenses	508,426	(376,473)
Accrued payroll and related liabilities	336,101	(4,005)
Net cash from operating activities	<u>\$ 2,639,982</u>	<u>\$ 650,942</u>
Noncash investing, capital and related financing activities		
Capital lease obligation incurred for use of equipment	\$ 182,200	\$ 33,697
Swap interest derivative liability	\$ -0-	\$ 364,577
Physician loan guarantees	\$ -0-	\$ 397,517
Supplemental cash flows information		
Cash paid for interest net of amounts capitalized of \$1,211,216 in 2007 and \$427,752 in 2006	\$ 15,493	\$ 177,725

See accompanying notes to combined financial statements.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

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

Blended Component Units

The Tipton County Memorial Hospital Foundation (the Foundation) is a blended component unit of the Hospital. The primary government appoints a voting majority of the Foundation's board and a financial benefit/burden relationship exists between the Hospital and the Foundation. Although it is legally separate from the Hospital, the Foundation is reported as if it were a part of the Hospital because it provides services entirely or almost entirely to the Hospital. The Foundation is a 501(c)(3) not-for-profit organization. To obtain the separate financials of the Foundation, please contact the Hospital's Financial Management, at Tipton County Memorial Hospital, 1000 S. Main St., Tipton, IN 46072, Michael Harlowe, President and CEO, Vernon Schmaltz, VP – Finance/CFO.

The Foundation's total assets (cash and cash equivalents) as of December 31, 2007 and 2006 were \$88,973 and \$74,712, respectively. The Foundation's net assets as of December 31, 2007 and 2006 were \$88,973 and \$74,712, respectively. The Foundation's total program revenue for the years ended December 31, 2007 and 2006 was \$55,666 and \$39,823, respectively. The Foundation's total program expenses for the years ended December 31, 2007 and 2006 were \$41,405 and \$22,357, respectively.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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 disclosures 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.

Principles of Combination

The accompanying combined financial statements include the accounts of Tipton County Memorial Hospital and its blended component unit, the Foundation. All material intercompany transactions have been eliminated. Because the Foundation's sole purpose is to support the activities of the Hospital, the results of these activities have been combined.

Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less. The Hospital maintains its cash in accounts, which at times, may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on cash and cash equivalents.

Assets Limited As To Use And Investments

Board Designated Funds: This fund includes investments set aside to fund its depreciation expense in order to meet capital equipment replacement needs. It also includes board designated funds set aside by the Hospital for other board directed purposes.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Trustee Held Assets: The Hospital funds certain debt requirements which are held by the trustee in accordance with the trust indenture.

Assets limited as to use that are required for obligations classified as current liabilities are reported in current assets

Patient Accounts Receivable and Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

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

Federal and State Income Taxes

The Hospital is a governmental instrumentality organized under Title 16, Article 12, of the Indiana statutes. The Hospital is exempt from federal income tax as a unit of local government.

Advertising

The Hospital expenses advertising costs as they are incurred. Advertising expenses for the years ended December 31, 2007 and 2006 were \$280,358 and \$303,598, respectively.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient revenue.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Capital Assets

Depreciable capital assets are depreciated on a straight-line basis over their estimated useful life. Estimated useful lives range from 3 to 40 years. The Hospital capitalizes property and equipment in excess of \$5,000 which have a useful life of at least two years. Capital lease assets are amortized over their estimated useful lives and are included in depreciation expense.

Grants and Contributions

From time to time, the Hospital receives grants as well as contributions from individuals and organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating income. Amounts restricted to capital acquisitions are reported after nonoperating income and expenses.

Restricted Resources.

When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

Net Assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, contributors external to the Hospital and internal designations by the board. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Operating Revenues And Expenses

The Hospital's combined statements of operations and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, the Hospital's principal activity. Nonexchange revenues, including investment income, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Compensated Absences

The Hospital maintains a Paid Time Off (PTO) policy. PTO accrual rates are determined based on the number of years of service. PTO accruals have maximums based on years of service and there is a 'cash-out' option in June and November of each year. Accrued PTO is paid to employees upon termination of employment if the employee has completed his or her 90 day probationary period. PTO is accrued when earned and reported as a liability.

Risk Management

The Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

Investments

Investments are reported at fair value, as determined by quoted market prices. Interest, dividends, and gains and losses, both realized and unrealized, on investments are included in nonoperating revenue when earned.

Bond Issue Costs

The Hospital provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs were approximately \$510,000. Issue costs are amortized utilizing the straight-line method. Accumulated amortization as of December 31, 2007 and 2006 is \$40,480 and \$20,240, respectively.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Costs of Borrowing

Except for capital assets acquired through gifts, contributions or capital grants, interest cost on borrowed funds, as well as interest earned on those funds, during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Capitalized interest cost was \$1,211,216 and \$427,752 in 2007 and 2006, respectively, and capitalized interest income was \$799,204 and \$205,185 in 2007 and 2006, respectively.

Minimum Revenue Guarantees (New Accounting Pronouncement)

In November 2005, the FASB issued FASB Staff Position No. 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners" ("FIN 45-3"). It served as an amendment to FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others" ("FIN 45") by adding minimum revenue guarantees to the list of examples of contracts to which FIN 45 applies.

Under FIN 45, a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. One example cited in FIN 45-3 involves a guarantee provided by a healthcare entity to a non-employed physician in order to recruit such physician to move to the entity's geographical area and establish a private practice, which is the approach the Hospital uses in recruiting physicians to the community. FIN 45 is effective for new minimum revenue guarantees issued or modified on or after January 1, 2006.

The Hospital adopted this amendment to FIN 45 effective January 1, 2006. For periods ending before January 1, 2006, the Hospital did not report the fair value of its obligations under physician revenue guarantee agreements. However, under FIN 45 as amended, the Hospital is required to report the liability for these physician revenue guarantees on its balance sheets at fair value and amortize the related prepaid physician recruitment expense over the period of the physician's contractual commitment to practice in the local community, which is typically three years. As of December 31, 2007 and 2006, the Hospital had entered and modified physician revenue guarantee agreements and it had an affect on the accompanying financial statements. See Note 10.

Reclassification

Certain items in the 2006 financial statements have been reclassified herein to conform to the current year presentation.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

2. AGENCY RELATIONSHIP

The Hospital entered into an agency relationship agreement with Clarian Health Partners during 1998. Clarian acting as the agent of the Hospital provides certain key personnel, administrative and clinical assistance including participation in a managed care plan and a clinical affiliation agreement and other specified assistance for which Clarian receives a management fee. Through the agency relationship Clarian had a funding obligation of \$1,000,000 that was paid in four installments of \$250,000 each ending in 2001. The funding obligation is for specific purposes including implementing a management plan, enhancing the Hospital's operations and systems, supporting the integration between the Hospital and Clarian and exploring innovative approaches to rural health care. The agreement required these payments be deposited into a restricted fund where the Board of Trustees of the Hospital and Clarian approved all withdrawals in advance. The restricted funds have been expended as of December 31, 2002. The Hospital is required to repay Clarian for the funding obligation annually with 20% of the operating income which excludes certain revenue from an agreement between the Hospital and Tipton County and the Hospital's investment and endowment income. Accordingly, the Hospital has accrued \$198,403 and \$3,481 as of December 31, 2007 and 2006, respectively. The minimum repayment of \$500,000 and the maximum of \$1,500,000 shall be repaid by the Hospital over the 10 year term of the agreement ending in 2008. The cumulative amount paid to Clarian Health Partners as of December 31, 2007 is approximately \$505,000. During 2007 the Hospital has entered into a Letter of Intent with Clarian to strengthen the affiliation agreement.

3. CHARITABLE ASSETS HELD BY OTHERS

The Hospital is named as the beneficiary of certain assets held by an independent organization. The assets fair value as of December 31, 2007 and 2006, is approximately \$7,356,000 and \$6,842,000, respectively. The assets are maintained by a trustee and are invested in stocks, bonds and cash. The corpus of the assets is to be held in perpetuity with the Hospital receiving the income generated.

4. CHARITY CARE

Charges excluded from net patient service revenue under the Hospital's charity care policy were \$878,776 and \$494,598 for 2007 and 2006, respectively.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

5. ASSETS LIMITED AS TO USE

The composition of assets limited as to use includes the following as of December 31:

	<u>2007</u>	<u>2006</u>
Board designated		
Funded depreciation		
Cash and cash equivalents	\$ 517,721	\$ 47,593
Investments	9,840,014	9,660,841
Accrued interest receivable	76,390	78,872
	<u>10,434,125</u>	<u>9,787,306</u>
Trustee held assets		
Cash and cash equivalents	34,952	607,465
Investments	8,553,469	17,088,890
	<u>8,588,421</u>	<u>17,696,355</u>
Total assets limited as to use	<u>\$ 19,022,546</u>	<u>\$ 27,483,661</u>

6. DEPOSITS AND INVESTMENTS

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

Investments are carried at fair market value as determined by quoted market prices. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Funded depreciation investments consist of cash equivalents and U.S. Government securities.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

The Hospital's investments generally are reported at fair value, as discussed in Note 1. As of December 31, 2007 and 2006, the Hospital had the following investments and maturities, all of which were held in the Hospital's name by custodial banks that are agents of the Hospital.

December 31, 2007

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Fixed income obligations	\$ 936,979	\$ 375,347	\$ 561,632	\$ -0-	\$ -0-
U.S. Government Securities	13,875,855	10,746,714	2,702,884	-0-	426,257
Certificates of Deposit	597,967	532,967	65,000	-0-	-0-
Mutual Funds	3,059,072	3,059,072	-0-	-0-	-0-
	<u>\$ 18,469,873</u>	<u>\$ 14,714,100</u>	<u>\$ 3,329,516</u>	<u>\$ -0-</u>	<u>\$ 426,257</u>

December 31, 2006

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Fixed income obligations	\$ 1,188,175	\$ 387,352	\$ 800,823	\$ -0-	\$ -0-
U.S. Government Securities	21,014,869	17,633,686	2,451,244	445,097	484,842
Certificates of Deposit	553,000	438,000	115,000	-0-	-0-
Mutual Funds	4,072,559	4,072,559	-0-	-0-	-0-
	<u>\$ 26,828,603</u>	<u>\$ 22,531,597</u>	<u>\$ 3,367,067</u>	<u>\$ 445,097</u>	<u>\$ 484,842</u>

Interest rate risk - The Hospital does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Credit risk - Statutes authorize the Hospital to invest in interest bearing deposit accounts, passbook savings accounts, certificates of deposit, money market accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Concentration of credit risk - The Hospital places no limit on the amount it may invest in any one issuer. The Hospital maintains its investments, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on investments.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Deposits and investments consist of the following as of December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Carrying amount		
Deposits	\$ 3,247,106	\$ 3,294,704
Investments	18,469,873	26,828,603
	<u>\$21,716,979</u>	<u>\$30,123,307</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 2,694,433	\$ 2,639,646
Assets limited as to use	19,022,546	27,483,661
	<u>\$ 21,716,979</u>	<u>\$ 30,123,307</u>

7. ACCOUNTS RECEIVABLE AND PAYABLE

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at December 31, 2007 and 2006 consisted of the following amounts:

	<u>2007</u>	<u>2006</u>
Patient accounts receivable		
Receivable from patients and their insurance carriers	\$ 5,185,664	\$ 4,920,104
Receivable from Medicare	3,099,730	2,710,007
Receivable from Medicaid	342,137	675,191
Total patient accounts receivable	8,627,531	8,305,302
Less contractual allowances	3,145,908	2,817,305
Less allowance for uncollectible amounts	780,468	1,299,653
Patient accounts receivable, net	<u>\$ 4,701,155</u>	<u>\$ 4,188,344</u>
Accounts payable and accrued expenses		
Accrued payroll and payroll taxes	\$ 920,551	\$ 774,922
Payable to suppliers	1,421,730	913,304
Accrued compensated absences	787,903	744,062
Accrued employee health benefit claims	332,666	186,035
Total accounts payable and accrued expenses	<u>\$ 3,462,850</u>	<u>\$ 2,618,323</u>

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

8. CAPITAL ASSETS

A summary of capital assets at December 31, 2007 and 2006, follows:

	Balance December 31, 2006				Balance December 31, 2007	
	Additions	Retirements	Transfers			
Land	\$ 125,482	\$ -0-	\$ -0-	\$ -0-	\$ 125,482	
Land improvements	616,387	-0-	-0-	700,384	1,316,771	
Buildings	17,057,444	207,851	-0-	-0-	17,265,295	
Equipment	19,794,173	1,394,821	(908,869)	-0-	20,280,125	
Construction in progress	2,850,695	10,258,913	-0-	(700,384)	12,409,224	
Total capital assets	40,444,181	11,861,585	(908,869)	-0-	51,396,897	
Less accumulated depreciation						
Land improvements	616,161	48,100	-0-	-0-	664,261	
Buildings	16,325,457	953,612	-0-	-0-	17,279,069	
Equipment	6,510,916	694,631	(895,873)	-0-	6,309,674	
Total accumulated depreciation	23,452,534	1,696,343	(895,873)	-0-	24,253,004	
Capital assets, net	\$ 16,991,647	\$ 10,165,242	\$ (12,996)	\$ -0-	\$ 27,143,893	
	Balance December 31, 2005				Balance December 31, 2006	
	Additions	Retirements	Transfers			
Land	\$ 125,482	\$ -0-	\$ -0-	\$ -0-	\$ 125,482	
Land improvements	616,387	-0-	-0-	-0-	616,387	
Buildings	16,734,340	323,104	-0-	-0-	17,057,444	
Equipment	19,356,987	785,685	(348,499)	-0-	19,794,173	
Construction in progress	194,464	2,656,231	-0-	-0-	2,850,695	
Total capital assets	37,027,660	3,765,020	(348,499)	-0-	40,444,181	
Less accumulated depreciation						
Land improvements	604,099	12,062	-0-	-0-	616,161	
Buildings	15,362,572	962,885	-0-	-0-	16,325,457	
Equipment	6,066,725	750,433	(306,242)	-0-	6,510,916	
Total accumulated depreciation	22,033,396	1,725,380	(306,242)	-0-	23,452,534	
Capital assets, net	\$ 14,994,264	\$ 2,039,640	\$ (42,257)	\$ -0-	\$ 16,991,647	

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

9. INTEREST RATE SWAP LIABILITY

During the year ended December 31, 2006, the Hospital entered into a “cash flow hedge interest rate swap” agreement with an investment company. The Hospital pays a fixed interest rate and the investment company pays a variable interest rate (3.47% and 3.96% at December 31, 2007 and 2006, respectively) over the term of the agreement.

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

The swap was effective on June 29, 2006 and matures on June 1, 2016. It contains an outstanding notional amount of \$18,400,000 with a 3.875% fixed rate of interest and is a derivative liability for the Hospital with a fair value as of December 31, 2007 and 2006 of \$643,587 and \$364,577, respectively. The interest rate swap liability is payable should the Hospital terminate the agreement.

The total interest rate swap unrealized loss recognized on the financial statements was \$279,010 and \$364,577 for the years ended 2007 and 2006, respectively.

10. PHYSICIAN RELOCATION AGREEMENTS AND OTHER MINIMUM REVENUE GUARANTEES

Consistent with the Hospital’s policy on physician relocation and recruitment, the Hospital provides income guarantee agreements to certain physicians who agree to relocate to the community to fill a need in the Hospital’s service area and commit to remain in practice there. Under such agreements, the Hospital is required to make payments to the physicians in excess of the amounts they earn in their practice up to the amount of the income guarantee. The income guarantee periods are typically two years. Such payments are recoverable from the physicians if they do not fulfill their commitment period to the community, which is typically three years. The Hospital also provides minimum revenue collection guarantees to Hospital-based physician groups providing certain services at our Hospital with terms ranging from one to three years. At December 31, 2007, the maximum potential amount of future payments under these guarantees was approximately \$203,000.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

In accordance with FASB Staff Position FIN 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners," during the year ended December 31, 2006, the Hospital recorded a liability of approximately \$572,000 for the fair value of new or modified guarantees entered into during this period with an offsetting asset recorded in other assets on the accompanying balance sheet, which will be amortized over the commitment period. Approximately \$195,000 and \$174,000 was amortized during 2007 and 2006.

11. LINE OF CREDIT

The Hospital obtained a \$750,000 a line of credit during 2007. The line of credit is secured by all personal property of the Hospital. It is due September 24, 2008 and bears interest at the prime rate charged by the financial institution. There were no borrowings on the line of credit during 2007.

12. LONG-TERM DEBT

The Hospital's 1997 and 2002 bonds were retired during 2006. The defeasance of the 1997 and 2002 bonds resulted in a loss of approximately \$101,000 which is amortized through 2017 as a component of interest expense.

The Hospital's \$24,200,000, 2006 Series A Revenue Bonds are due in varying installments of \$315,000 to \$1,660,000 plus variable interest (3.96% at December 31, 2007) through June 1, 2031. The \$2,590,000, 2006 Series B Revenue Bonds are due in varying installments of \$470,000 to \$745,000 plus variable interest (5.4% at December 31, 2007) through June 1, 2011. During 2006, the Hospital entered into an interest rate swap agreement (see footnote 9).

The Hospital has available letters of credit for \$24,498,347 and \$2,628,318 with a bank for the Series 2006 A and B revenue bonds, respectively. The letters of credit are intended to provide credit enhancement and liquidity support for the Hospital's Series 2006 A and B revenue bonds. Advances bear interest at a maximum interest rate of 10% and 12% per year for the Series 2006 A and B revenue bonds, respectively. The letters of credit both expire June 15, 2011. There were no balances outstanding as of December 31, 2007 and 2006.

The Hospital has several capital lease obligations with imputed interest rates of 4% to 7.5%, collateralized by the leased equipment with a cost of \$779,243 and \$597,043 as of December 31, 2007 and 2006, respectively. Accumulated depreciation on capitalized assets totaled \$292,548 and \$205,112 as of December 31, 2007 and 2006, respectively.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

A summary of long-term debt at December 31, 2007 and 2006 follows:

	Balance December 31, 2006	Additional borrowings	Payments	Balance December 31, 2007	Amounts due within one year
Revenue bonds					
Hospital Association					
\$24,200,000 2006 Series A	\$ 24,200,000	\$ -0-	\$ -0-	\$ 24,200,000	\$ -0-
\$2,590,000 2006 Series B	2,590,000	-0-	-0-	2,590,000	665,000
Unamortized bond defeasance loss	(96,697)	-0-	(9,209)	(87,488)	(9,209)
Capital Leases					
Capital Leases	330,023	182,200	124,707	387,516	143,737
	\$ 27,023,326	\$ 182,200	\$ 115,498	\$ 27,090,028	\$ 799,528
	Balance December 31, 2005	Additional borrowings	Payments	Balance December 31, 2006	Amounts due within one year
Revenue bonds					
Hospital Association					
\$1,580,000 1997 Series A	\$ 604,166	\$ -0-	\$ 604,166	\$ -0-	\$ -0-
\$3,700,000 1997 Series B	2,674,829	-0-	2,674,829	-0-	-0-
\$3,760,000 2002 Series	3,262,018	-0-	3,262,018	-0-	-0-
\$24,200,000 2006 Series A	-0-	24,200,000	-0-	24,200,000	-0-
\$2,590,000 2006 Series B	-0-	2,590,000	-0-	2,590,000	-0-
Unamortized bond defeasance loss	-0-	(101,302)	(4,605)	(96,697)	(9,209)
Capital Leases					
Capital Leases	402,047	33,697	105,721	330,023	118,018
	\$ 6,943,060	\$ 26,722,395	\$ 6,642,129	\$ 27,023,326	\$ 108,809

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Scheduled principal payments of long-term debt at December 31, 2007 are as follows:

Year ending December 31,	Long-term debt		Capital lease obligations	
	Principal	Interest	Principal	Total
2008	\$ 665,000	\$ 1,051,340	\$ 143,737	\$ 18,814
2009	710,000	1,014,598	93,752	12,614
2010	745,000	975,369	42,824	9,193
2011	785,000	934,206	26,389	7,139
2012	820,000	896,416	28,436	5,092
2013-2017	4,595,000	3,995,874	52,378	3,502
2018-2022	5,530,000	3,066,243	-0-	-0-
2023-2027	6,655,000	1,947,083	-0-	-0-
2028-2031	6,285,000	600,676	-0-	-0-
	<u>\$ 26,790,000</u>	<u>\$ 14,481,805</u>	<u>\$ 387,516</u>	<u>\$ 56,354</u>

Long-term debt is secured by Hospital property and plant. The bonds also contain certain restrictive covenants. Management believes the Hospital is in compliance with all covenants as of December 31, 2007 and 2006.

13. PATIENT SERVICE REVENUE

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

Medicare - The Hospital has been granted Critical Access Status under which the Hospital is paid based upon a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports. Final determination of amounts earned is subject to review by the fiscal intermediary. Medicare reports have been settled through 2005. Management believes adequate provision has been made in the financial statements for any adjustments.

Medicaid - Inpatient and outpatient services rendered to the Medicaid program are paid based upon on a prospectively determined rates.

TIPTON COUNTY MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Revenue from the Medicare and Medicaid programs accounted for approximately 46 percent and 8 percent, respectively, of the Hospital's net patient revenue for the years ended 2007 and 2006. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Hospital participates in the Disproportionate Share Hospital program. Subject to certain qualification criteria, the Hospital is entitled to participate in the program annually. This program is a Federal program administered by the state. There is currently a one year moratorium on a change in the regulation related to the eligibility to participate in the program, which if left unchanged would expire in May 2008. The ultimate outcome and potential impact of the change in the regulation is unknown.

The Hospital also has entered into payment agreements with certain commercial insurance carriers. The basis for payment to the Hospital under these agreements could include prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Patient service revenue for 2007 and 2006 consists of the following:

	<u>2007</u>	<u>2006</u>
Inpatient revenue	\$ 16,891,617	\$ 15,824,553
Outpatient revenue	42,140,371	39,157,529
Gross patient service revenue	59,031,988	54,982,082
Contractual allowances	24,393,730	21,196,033
Bad debt expense	1,411,188	1,719,286
Charity care	878,776	494,898
Deductions from revenue	<u>26,683,694</u>	<u>23,410,217</u>
Net patient service revenue	<u>\$ 32,348,294</u>	<u>\$ 31,571,865</u>

14. EMPLOYEE HEALTH PLAN

The Hospital participates in a self-funded health plan covering substantially all employees. Covered services include medical benefits. The plan has annual reinsurance coverage for individual claims in excess of \$60,000 per year with an aggregate maximum of approximately \$2,530,000. Employee health plan expense was \$2,176,835 and \$2,134,912 for 2007 and 2006, respectively.

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Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

Changes in the balance of claim liabilities during the past two years are as follows:

	<u>2007</u>	<u>2006</u>
Unpaid claims, beginning of year	\$ 186,035	\$ 302,619
Incurred claims and changes in estimates	2,176,835	2,134,912
Claim payments	<u>(2,030,204)</u>	<u>(2,251,496)</u>
Unpaid claims, end of year	<u>\$ 332,666</u>	<u>\$ 186,035</u>

15. PENSION PLAN

The Hospital has a defined contribution pension plan that covers all employees who meet eligibility requirements as to age and length of service. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The plan was established by written agreement between the Hospital Board of Trustees and the plan administrator. The Hospital contributes 6% of annual covered payroll. Employer contributions to the plan were \$525,573 and \$578,372 for 2007 and 2006, respectively.

16. CONCENTRATIONS OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third party payors at December 31, 2007 and 2006 was as follows:

	<u>2007</u>	<u>2006</u>
Medicare	36%	33%
Medicaid	4%	8%
Blue Cross	17%	13%
Other third party payors	25%	25%
Self-pay	18%	21%
	<u>100%</u>	<u>100%</u>

TIPTON COUNTY MEMORIAL HOSPITAL

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17. DISCONTINUED OPERATIONS

During 2007, the Hospital discontinued certain lines of business including Delivery/Maternity, an Extended Care Unit, Homecare services and certain Behavioral Health services. Operating results are included in the loss from operations of the discontinued components in the statement of operations of \$88,872 and \$768,751 for 2007 and 2006, respectively. Net patient service revenues for the discontinued components were \$99,028 and \$2,187,732 for 2007 and 2006, respectively.

18. COMMITMENTS AND CONTINGENCIES

Litigation

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

Operating Leases

The Hospital leases various equipment and facilities under operating leases expiring at various dates through September 2011. Total rental expense in 2007 and 2006 for was \$1,221,348 and \$1,072,649 respectively.

The following is a schedule by year of future minimum lease payments under operating leases as of December 31, 2007, that have initial or remaining lease terms in excess of one year.

Year Ending December 31,	Amount
2008	\$ 473,277
2009	270,252
2010	193,044
2011	42,404

Malpractice Insurance

The Indiana Medical Malpractice Act, IC 27-12 (the Act), provides a recovery for an occurrence of malpractice and for any injury or death of a patient due to an act of malpractice in excess of certain thresholds. The Act requires the Hospital to maintain medical malpractice liability insurance on a per occurrence basis and in the annual aggregate for amounts below the thresholds of the Act.

TIPTON COUNTY MEMORIAL HOSPITAL

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Construction Commitments

The Hospital has committed to construction projects for a remaining estimated amount of approximately \$6 million. The project is to include renovations and/or new construction for site-work, emergency room, radiation, common area build-out, build-out of the med-surg unit and surgery area, a parking lot, a physical therapy addition, demolition of an existing structure, outpatient services upgrades and cafeteria upgrades as well the associated design and project management fees.

19. SUBSEQUENT EVENT

Effective January 1, 2008, the Hospital discontinued its Assisted Living line.