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August 16, 2010

Board of Directors  
Howard Regional Health System  
3500 S. Lafountain Street  
Kokomo, IN 46902

We have reviewed the audit report prepared by Blue & Company, LLC, Independent Public Accountants, for the period January 1, 2009 to December 31, 2009. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Howard Regional Health System, as of December 31, 2009, and the results of its operations for the period then ended, on the basis of accounting described in the report.

The Independent Public Accountants' report is filed with this letter in our office as a matter of public record.

STATE BOARD OF ACCOUNTS



**CONSOLIDATED FINANCIAL STATEMENTS**

**AND**

**SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2009 AND 2008**

*CPAs / ADVISORS*



# HOWARD REGIONAL HEALTH SYSTEM

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## REPORT OF INDEPENDENT AUDITORS

Board of Trustees  
Howard Regional Health System  
Kokomo, Indiana

We have audited the accompanying consolidated balance sheets of Howard Regional Health System (the System), as of December 31, 2009 and 2008, and the related consolidated statements of revenues and expenses, changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of the Howard Regional Health System Foundation, Inc. (the Foundation), a blended component unit, whose statements reflect total assets of \$4,077,903 and \$4,196,782 as of December 31, 2009 and 2008, respectively, and change in net assets of \$290,969 and (\$621,908), respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and in our opinion, insofar as it relates to the amounts for the Foundation, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States; Guidelines for Examination of Entities Receiving Financial Assistance From Governmental Sources 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

Board of Trustees  
Howard Regional Health System  
Kokomo, Indiana

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the System as of December 31, 2009 and 2008 and the results of its consolidated operations, changes in net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. This information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

Management's discussion and analysis as listed in the table of contents, is not a required part of the basic consolidated 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 consist 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*

May 27, 2010

**REQUIRED SUPPLEMENTARY INFORMATION**

# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

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This section of Howard Regional Health System's (the System) annual consolidated financial statements presents background information and management's discussion and analysis (MD&A) of the System's consolidated financial performance during the year ended December 31, 2009. This MD&A includes a discussion and analysis of the activities and results of the System, its blended component unit, Howard Regional Health System Foundation, and its majority owned subsidiaries as described in the notes to the consolidated financial statements.

This MD&A should be read together with the consolidated financial statements included in this report.

The System has two county-owned facilities and operates under the Indiana County Hospital Law, Indiana Code 16-22. It has a licensed and staffed 150-bed acute regional hospital and a 30-bed regional rehabilitation hospital both located in Kokomo, Indiana serving a nine county region in north central Indiana. The System provides short-term inpatient and outpatient health care among other services.

The Board of County Commissioners of Howard County appoints the Governing Board of the System and a financial benefit/burden relationship exists between the County and the System. For these reasons, the System is considered a component unit of Howard County.

### **HIGHLIGHTS OF THE YEAR ENDED DECEMBER 31, 2009**

Howard Regional Health System continues to offer a full range of inpatient and outpatient services. Even adjusting for a decline in volumes, the System continues to be the third largest employer in Howard County with two hospitals on three campuses plus clinics in Greentown, Grissom, and Frankfort.

Work continues on the System's 2009-2012 strategic plan, which focuses on five major areas:

1. Outstanding quality
2. Superior service
3. Exceptional people
4. Ongoing growth
5. Consistent strength

A System-wide initiative to train and coach System leadership and staff began in partnership with the Studer Group. The Studer Group is nationally renowned firm devoted to teaching prescriptive tools and processes that organizations can use immediately to create and sustain service and operational excellence.

# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

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The goal of this training is to connect each person employed by the System to the five areas listed above, thereby increasing quality of the care provided, patient satisfaction, employee satisfaction, and financial viability for the future.

### **Physician Recruitment**

The employment of physicians and physician groups is a strategic measure many hospitals are taking to help build patient volumes. Over the past decade, one of the System's strategies has been to recruit and secure relationships with primary care physicians. This strategy was behind the formation of Community Family Health Center, North Central Indiana Pediatric Center, Pulmonary Care Center, Community OB/GYN Center and our internal medicine practices.

In order to fulfill our primary mission of providing exceptional quality care, we have made a commitment to further expand and secure a solid base of primary care physicians. As a result, Dr. Cecelia Powless, OB/GYN, and Dr. Kambiz Karimi, internal medicine, joined the System's staff in 2009.

The System also successfully added additional employed specialists during 2009: Dr. Ayla Bakar, endocrinologist; Dr. Mohammad Nekoomaram, orthopaedics; and in early 2010 Dr. Andrew Mandery, plastic and cosmetic surgeon.

### **Facility Growth**

Positioning for the future, we continued our strategic plan for facility growth both within the Main Campus hospital and in outpatient areas. The System took over operation of the Imaging Center of North Central Indiana on January 1, 2008. Plans moved forward, which will result in the Woman's Center being moved to the Imaging Center in 2010.

### **Indiana Health Information Exchange**

Howard Regional Health System implemented clinical information exchange through Indiana Health Information Exchange's (IHIE) DOCS4DOCS® service. Both Howard Regional and St. Joseph Hospital, Kokomo, have implemented IHIE's secure, Web-based service that delivers clinical reports like lab results, reports, and treatment information in real-time, sent instantly to where it needs to be for patient care (outpatient centers and ambulatory practices).

### **Electronic Medical Record**

Research into potential Electronic Medical Record continued in 2009. The *Cerner* person-centric solution framework has been chosen to advance the digitization of individual electronic medical records to meet the needs of our hospital, providers and patients.

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# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

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### **Pandemic Planning**

In anticipation of the H1N1 pandemic projected for the country, a multi-disciplinary team developed and implemented a comprehensive plan which included opening a Command Center, providing daily/weekly situation reports to all employees, patient triage, and installation of mask/glove/hand sanitizer dispensers throughout the hospital, public and physician communications.

### **Charity Care**

The System provided approximately \$8,723,000 of charity care to the community in 2009. This compares to \$8,119,000 in 2008 or a 7% increase.

### **Marketable Securities**

We are exposed to market risk related to changes in value of securities. The investment in mutual fund fixed income and equity securities was \$26.59 million as of December 31, 2009 compared to \$20.99 million as of December 31, 2008. These investments are carried at fair value, with changes in unrealized gains and losses being recorded in investment income (loss). During 2009, we had investment income of approximately \$4.82 million compared to an investment loss of approximately \$7.03 million in 2008.

### **Interest Rate Swap Agreements**

We are exposed to market risk related to changes in interest rates and we entered into interest rate swap agreements to manage our exposure to these fluctuations. Our interest rate swap agreements involve the exchange of fixed and variable rate interest payments between two parties, based on common notional principal amounts and maturity dates. The notional amounts of the swap agreements represent balances used to calculate the exchange of cash flows. Our credit risk related to these agreements is considered low because the swap agreements are with creditworthy financial institutions. The interest payments under these agreements are settled on a net basis. These derivatives have been recognized in the financial statements at their respective fair value. Changes in the fair value of these derivatives are included in the statement of revenues and expenses. During 2009, the System recognized an unrealized gain on the swap agreements of approximately \$5.77 million compared to an unrealized loss of approximately \$7.66 in 2008.

# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

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### Accreditations

During 2009, the following accreditations were achieved or renewed:

The System is one of only 18 Indiana Emergency Medical Technician-Paramedic Programs to receive accreditation from the Commission on Accreditation of Allied Health Education Programs.

The System's Oncology Program earned a three-year reaccreditation with commendation from the American College of Surgeons Commission on Cancer (CoC), a consortium of professional organizations dedicated to improving survival and quality of life for cancer patients. The System is the only cancer program in Howard County to receive the accreditation.

The System was awarded a three-year term of accreditation in Ultrasound Imaging Services by the American College of Radiology (ACR). The ACR-accreditation demonstrates that the System has voluntarily undergone a comprehensive review process and meets nationally accepted high standards of care.

The System's West Campus Specialty Hospital Sleep Disorders Center was accredited by the American Academy of Sleep Medicine. The West Campus Sleep Disorders Center diagnoses and treats a variety of sleep disorders in adults and children over the age of four. These include sleep apnea, obstructive sleep apnea, insomnia, narcolepsy, restless leg syndrome and others.

Inpatient imaging services received accreditation by the American College of Radiology (ACR) in Ultrasound. The System is the only ultrasound accredited facility listed on the ACR website. ACR accreditation in Nuclear Medicine and CT was attained in early 2010.

Other accreditations and certifications include but are not limited to:

- The Intersocietal Commission for the Accreditation of Nuclear Medicine Laboratories (ICANL)
- The Intersocietal Commission for the Accreditation of Echo Laboratories ICAEL
- The Intersocietal Commission for the Accreditation of Vascular Laboratories ICAVL
- American Association of Cardiovascular & Pulmonary Rehabilitation
- American College of Radiology accreditation in Mammography
- State of Indiana Family and Social Services Administration, Division of Mental Health
- American Diabetes Association
- Department of Health & Human Services, Health Care Financing Administration

# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

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### **LOOKING AHEAD TO 2010**

We continue to make plans to convert to an electronic medical record system (EMR). With an EMR, complete near real-time records can be viewed anytime from anywhere in the secure network, and records can be accessed concurrently by caregivers who have a need to view the information in the provision of care. Faster access from more places means caregivers have the most current information at their fingertips to make quick and evidence-based healthcare decisions.

Quality, patient safety and patient satisfaction will continue to be priorities at the System in the year and years ahead. Working with guidelines provided by state and national healthcare organizations, we are committed to providing exceptional quality, patient-centered care.

### **USING THIS ANNUAL REPORT**

The System's consolidated financial statements consist of four statements – a Balance Sheet; a Statement of Revenues and Expenses, a Statement of Changes in Net Assets; and a Statement of Cash Flows. These consolidated financial statements and related notes provide information about the activities and the financial position of the System.

The Consolidated Balance Sheet includes all of the System's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to System creditors (liabilities).

All of the current year's revenue earned and expenses incurred are accounted for in the Consolidated Statement of Revenues and Expenses. The Consolidated Statements of Changes in Net Assets summarizes the changes in net assets for the year.

Finally, the Consolidated Statement of Cash Flows' purpose is to provide information about the System's cash flows from operating activities, financing activities including capital additions, and investing activities. This statement provides information on the sources and uses of cash and the change in cash balance during the year.

### **THE BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES**

One of the most important questions asked about the System's finances is, "Is the System as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues and expenses report information about the System'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.

# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

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These two statements report the System's net assets and changes in them. Think of the System's net assets—the difference between assets and liabilities—as one way to measure the System's financial health, or financial position. Over time, increases or decreases in the System's net assets are one indicator of whether its financial health is improving or deteriorating. Consider other nonfinancial factors, however, such as changes in the System's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the System.

**Table 1 – Balance Sheets**

	<u>2009</u>	<u>2008</u>
Current assets	\$ 68,077,930	\$ 58,499,435
Assets whose use is limited	74,877	7,491,193
Capital assets, net	84,012,667	89,318,608
Other assets	1,767,749	2,387,156
	<u>\$ 153,933,223</u>	<u>\$ 157,696,392</u>
Current liabilities	\$ 43,067,072	\$ 18,921,710
Long-term liabilities	33,711,176	70,059,059
Total liabilities	76,778,248	88,980,769
Net assets	77,154,975	68,715,623
	<u>\$ 153,933,223</u>	<u>\$ 157,696,392</u>

Total assets decreased approximately \$3.77 million from December 31, 2008 mainly in capital assets as depreciation outpaced current property additions.

Liabilities decreased approximately \$12.2 million mainly related to a decrease in the interest rate swap agreement liability and other current liability changes.

Net assets increased approximately \$8.44 million mainly due to stronger operating

# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

**Table 2 – Statements of Revenues and Expenses**

	2009		2008	
	Amount	Ratio	Amount	Ratio
Total revenues	\$ 157,867,028	100.0%	\$ 156,318,178	100.0%
Salaries and benefits	79,219,704	50.2%	82,886,775	53.0%
Supplies and drugs	27,570,181	17.5%	28,924,823	18.5%
Purchased services	10,070,495	6.4%	9,168,827	5.9%
Depreciation and amortization	9,909,307	6.3%	9,744,425	6.2%
Other	27,592,248	17.5%	27,375,982	17.5%
Total operating expenses	154,361,935	97.8%	158,100,832	101.1%
Operating income (loss)	3,505,093	2.2%	(1,782,654)	-1.1%
Nonoperating revenues (expenses), net	6,771,322	4.3%	(18,767,158)	-12.0%
Consolidated change in net assets	10,276,415	6.5%	(20,549,812)	-13.1%
Less amount attributable to non-controlling interest	(1,721,258)	-1.1%	(1,867,104)	-1.2%
Change in net assets attributable to controlling interest	\$ 8,555,157	5.4%	\$ (22,416,916)	-14.3%

Total revenues increased approximately \$1.55 million mainly due to net patient service revenue. Expenses decreased approximately \$3.74 million mainly through salaries and benefits. Together operating income increased \$5.3 million over 2008 to a total of \$3.5 million.

Nonoperating revenues and expenses increased approximately \$25.54 million over 2008 to a total of \$6.77 million. Investment income and the unrealized gain on the interest rate swap agreement were the main contributing factors.

### STATEMENT OF CASH FLOWS

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments and 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 the cash balance during the reporting period?”

# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

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A summary of cash flows follows:

<b>Cash Flows Data</b>	<u>2009</u>	<u>2008</u>
From operating activities	\$ 10,461,447	\$ 12,872,769
From capital and related financing activities	(12,268,526)	(19,171,976)
From investing activities	<u>(556,198)</u>	<u>3,005,009</u>
Change in cash and cash equivalents	<u>\$ (2,363,277)</u>	<u>\$ (3,294,198)</u>

Total cash and cash equivalents decreased approximately \$2.36 million over 2008 as capital additions and debt service payments combined with classification of investments outpaced cash provided by operating activities.

### SOURCES OF REVENUE

The System's revenues depend upon inpatient occupancy levels, the ancillary services and therapy programs ordered by physicians and provided to patients, the volume of outpatient procedures and the negotiated payment rates for such services. The gross charges typically do not reflect what is actually paid. The System has entered into agreements with third party payers, including government programs and managed care health plans, under which payments for healthcare services provided to patients are based upon predetermined rates per diagnoses or discounts from gross charges. The System receives a significant portion of its revenues from government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. Revenues from Medicare and Medicaid programs increased to 58% of gross revenues in 2009 from 55% in 2008. Legislative changes continue to limit or reduce the levels of payments from these programs.

The approximate percentages of gross patient revenues were:

	<u>2009</u>	<u>2008</u>
Medicare	47%	46%
Medicaid	11%	9%
Blue Cross/Blue Shield	20%	25%
Commercial	13%	13%
Other	<u>9%</u>	<u>7%</u>
	<u>100%</u>	<u>100%</u>

# HOWARD REGIONAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

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### CAPITAL ASSETS

	2009	2008	Change
Land	\$ 1,002,878	\$ 1,002,878	\$ -0-
Land improvements	6,554,573	6,467,686	86,887
Buildings and improvements	95,378,684	93,655,858	1,722,826
Equipment	62,421,888	63,494,462	(1,072,574)
Construction in progress	3,827,495	4,223,373	(395,878)
	<u>169,185,518</u>	<u>168,844,257</u>	<u>341,261</u>
Accumulated depreciation	85,172,851	79,525,649	5,647,202
	<u>\$ 84,012,667</u>	<u>\$ 89,318,608</u>	<u>\$ (5,305,941)</u>

Gross additions to property were approximately \$4.98 million before retirements of approximately \$4.64 million. Depreciation expense was approximately \$9.84 million before retirements of approximately \$4.19 million for a net decrease in capital assets of approximately \$5.31 million.

### LONG TERM DEBT

As of December 31, 2009, the System had \$61.7 million in short term and long term notes and bonds outstanding, a decrease from the \$64.1 million as of December 31, 2008. The decrease relates to regular principal payments on existing debt with no additions during 2009. More detailed information about the System's long term debt is presented in the notes to the consolidated financial statements.

### ECONOMIC OUTLOOK

Management believes that the healthcare industry operating margins will continue to be under significant pressure because of changes in payer mix and growth in operating expenses in excess of the increase in prospective payments under the Medicare and Medicaid programs. The ongoing challenge facing the System and the entire healthcare market is to continue to provide quality patient care in a competitive environment and to attain reasonable rates for the services it provides while managing its costs. The most significant cost factor affecting the System and the industry in general is the spiraling increase in labor costs due to a nationwide shortage of nurses and other healthcare specialists. The System expects the nursing shortage to continue and has implemented various initiatives to better position itself to attract and retain qualified nursing personnel and improve productivity.

# HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2009 AND 2008

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## **CONTACTING THE SYSTEM'S FINANCIAL MANAGEMENT**

This report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the System at 3500 South Lafountain Street, Kokomo, Indiana 46904, (765) 453-0702.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2009 AND 2008

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	<u>2009</u>	<u>2008</u>
<b>Current assets</b>		
Cash and cash equivalents	\$ 12,250,295	\$ 11,937,369
Investments	19,150,491	15,674,767
Patient accounts receivable, net of estimated uncollectibles of \$10,069,994 in 2009 and \$10,145,303 in 2008	19,964,045	21,132,109
Other receivables	2,570,250	3,056,842
Inventory and other current assets	6,258,730	5,755,620
Estimated third party settlements	200,909	122,728
Current portion of assets whose use is limited	<u>7,683,210</u>	<u>820,000</u>
Total current assets	68,077,930	58,499,435
<b>Assets whose use is limited</b>		
Internally designated	7,683,210	6,409,051
Held by trustee	<u>74,877</u>	<u>1,902,142</u>
Total assets whose use is limited	7,758,087	8,311,193
Less current portion	<u>7,683,210</u>	<u>820,000</u>
Noncurrent portion of assets whose use is limited	74,877	7,491,193
<b>Capital assets, net</b>	84,012,667	89,318,608
<b>Other assets</b>	<u>1,767,749</u>	<u>2,387,156</u>
 Total assets	 <u><u>\$ 153,933,223</u></u>	 <u><u>\$ 157,696,392</u></u>

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See accompanying notes to consolidated financial statements.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2009 AND 2008

### LIABILITIES AND NET ASSETS

	<u>2009</u>	<u>2008</u>
<b>Current liabilities</b>		
Accounts payable and accrued expenses	\$ 3,541,652	\$ 4,468,625
Accrued liabilities	7,836,802	10,273,466
Other current liabilities	962,423	1,625,104
Current portion of revenue bonds payable	855,000	820,000
Current portion of loans payable	705,245	1,042,995
Current portion of capital lease obligations	165,950	691,520
Current portion of revenue bonds payable due to letter of credit expiration	29,000,000	-0-
Total current liabilities	<u>43,067,072</u>	<u>18,921,710</u>
<b>Long term debt</b>		
Revenue bonds payable	18,220,000	48,075,000
Capital lease obligations	71,627	-0-
Loans payable	<u>12,663,025</u>	<u>13,461,939</u>
Total long term debt	30,954,652	61,536,939
<b>Other long term liabilities</b>	<u>2,756,524</u>	<u>8,522,120</u>
Total liabilities	76,778,248	88,980,769
<b>Net assets</b>		
Invested in capital assets, net of related debt	22,331,820	25,227,154
Restricted		
For debt service	74,877	1,902,142
Expendable for capital improvements	7,683,210	6,409,051
Expendable for other specific purposes	10,885	10,885
Held by Foundation	<u>3,202,847</u>	<u>2,911,877</u>
Total restricted net assets	10,971,819	11,233,955
Unrestricted	<u>41,377,032</u>	<u>29,664,405</u>
Net assets - controlling interest	74,680,671	66,125,514
Non-controlling interest	<u>2,474,304</u>	<u>2,590,109</u>
Total net assets	<u>77,154,975</u>	<u>68,715,623</u>
Total liabilities and net assets	<u>\$ 153,933,223</u>	<u>\$ 157,696,392</u>

See accompanying notes to consolidated financial statements.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATED STATEMENTS OF REVENUES AND EXPENSES YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
<b>Revenues</b>		
Net patient service revenue	\$ 143,713,671	\$ 142,168,617
Other	14,153,357	14,149,561
Total revenues	157,867,028	156,318,178
<b>Operating expenses</b>		
Salaries and wages	64,591,140	68,149,272
Employee benefits	14,628,564	14,737,503
Medical professional fees	5,727,377	4,516,515
Medical supplies and drugs	27,570,181	28,924,823
Purchased services	10,070,495	9,168,827
Equipment rentals	8,254,540	8,512,114
Utilities and telephone	3,050,976	3,052,936
Insurance	1,151,725	1,218,909
Depreciation and amortization	9,909,307	9,744,425
Other	9,407,630	10,075,508
Total expenses	154,361,935	158,100,832
Operating income (loss)	3,505,093	(1,782,654)
<b>Nonoperating revenues (expenses)</b>		
Investment income (loss)	4,815,268	(7,029,464)
Interest expense	(3,166,142)	(3,343,341)
Unrealized gain (loss) on derivatives	5,765,596	(7,659,767)
Other nonoperating expenses	(643,400)	(734,586)
Total nonoperating revenues (expenses), net	6,771,322	(18,767,158)
<b>Consolidated change in net assets</b>	10,276,415	(20,549,812)
Less amount attributable to non-controlling interest	(1,721,258)	(1,867,104)
Change in net assets attributable to controlling interest	\$ 8,555,157	\$ (22,416,916)

See accompanying notes to consolidated financial statements.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2009 AND 2008

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	<u>Controlling Interest</u>	<u>Non-controlling Interest</u>	<u>Total</u>
<b>Net asset balances</b>			
December 31, 2007	\$ 88,542,430	\$ 3,153,677	\$ 91,696,107
Consolidated change in net assets	(22,416,916)	1,867,104	(20,549,812)
Distributions	<u>-0-</u>	<u>(2,430,672)</u>	<u>(2,430,672)</u>
December 31, 2008	66,125,514	2,590,109	68,715,623
Consolidated change in net assets	8,555,157	1,721,258	10,276,415
Distributions	<u>-0-</u>	<u>(1,837,063)</u>	<u>(1,837,063)</u>
December 31, 2009	<u>\$ 74,680,671</u>	<u>\$ 2,474,304</u>	<u>\$ 77,154,975</u>

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See accompanying notes to consolidated financial statements.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
<b>Operating activities</b>		
Cash received from patients and third party payors	\$ 144,803,554	\$ 150,148,178
Cash paid to vendors for goods and services	(68,348,787)	(66,530,436)
Cash paid for employee wages and benefits	(80,146,677)	(84,894,534)
Other receipts, net	14,153,357	14,149,561
Net cash flows from operating activities	10,461,447	12,872,769
<b>Capital and related financing activities</b>		
Acquisition and construction of capital assets	(4,977,541)	(10,256,962)
Loss on disposal of property and equipment	122,827	430,439
Distributions to non-controlling interest	(1,837,063)	(2,430,672)
Interest on long term debt	(3,166,142)	(3,343,341)
Borrowings on long term debt	-0-	1,110,805
Principal paid on long term debt	(2,410,607)	(4,682,245)
Net cash flows from capital and related financing activities	(12,268,526)	(19,171,976)
<b>Investing activities</b>		
Investment income (loss)	4,815,268	(7,029,464)
Investment in affiliated companies, net	619,407	2,117,043
Other nonoperating revenues and expenses	(643,400)	(734,586)
Other changes in investments and assets whose use is limited	(5,347,473)	8,652,016
Net cash flows from investing activities	(556,198)	3,005,009
Net change in cash and cash equivalents	(2,363,277)	(3,294,198)
<b>Cash and cash equivalents, beginning of year</b>	14,933,101	18,227,299
<b>Cash and cash equivalents, end of year</b>	\$ 12,569,824	\$ 14,933,101
<b>Reconciliation of cash and cash equivalents</b>		
In current assets	\$ 12,250,295	\$ 11,937,369
In investments	156,731	695,812
In assets whose use is limited - internally designated	87,921	397,778
In assets whose use is limited - held by trustee	74,877	1,902,142
<b>Cash and cash equivalents, end of year</b>	\$ 12,569,824	\$ 14,933,101

See accompanying notes to consolidated financial statements.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
<b>Reconciliation of operating income (loss) to net cash flows from operating activities</b>		
Operating income (loss)	\$ 3,505,093	\$ (1,782,654)
Adjustments to reconcile operating income (loss) to net cash flows from operating activities		
Depreciation and amortization	9,909,307	9,744,425
Bad debts	9,790,137	9,859,435
Changes in operating assets and liabilities		
Patient accounts receivable	(8,622,073)	(7,754,603)
Other receivables	486,592	(76,095)
Estimated third party settlements	(78,181)	5,874,729
Inventory and other assets	(503,110)	(383,779)
Accounts payable and accrued expenses	(926,973)	(2,007,759)
Accrued liabilities and other liabilities	(2,436,664)	(102,182)
Other current liabilities	(662,681)	(498,748)
Net cash flows from operating activities	\$ 10,461,447	\$ 12,872,769
 <b>Supplemental disclosures of cash flow information</b>		
Cash paid for interest, net of capitalized interest of \$137,000 in 2009 and \$275,000 in 2008	\$ 3,166,142	\$ 3,343,341
 <b>Noncash capital and related financing activities</b>		
Capital lease obligations incurred for use of capital assets	\$ -0-	\$ 128,000
Net capital assets transferred from subsidiary	\$ -0-	\$ 5,485,409
Debt and capital lease obligations transferred from subsidiary	\$ -0-	\$ 4,757,177

See accompanying notes to consolidated financial statements.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Organization and Reporting Entity

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

Accounting principles generally accepted in the United States of America require that these consolidated financial statements present the System (primary government) and its significant component units. The component units discussed below are included in the System's reporting entity because of the significance of their operational or financial relationships with the System. 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

Howard Regional Health System Foundation, Inc. (the Foundation) is a blended component unit of the System. The Foundation is a separate not-for-profit entity organized to support the operations of the System. Financial statements for the Foundation can be obtained by contacting the Foundation office.

Other component units included in the consolidated financial statements based on the System's control of these entities are:

- Howard Regional Specialty Care, LLC
- Midwest Racquetball, Inc. dba Kokomo Sports Center
- Howard Community Surgery Center, LLC
- The Imaging Center of North Central Indiana, Inc.

All significant intercompany transactions have been eliminated in the consolidated financial statements.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### Use of Estimates

The preparation of consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Enterprise Fund Accounting

The System utilizes the enterprise fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

### Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System 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.

### Investments

Certificates of deposit, demand deposits, money market funds and similar negotiable instruments that are not reported as cash and cash equivalents are reported as investments at contract value which approximates fair value.

Mutual funds are reported at fair value based on the fund's market price. .

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating income in the consolidated statements of revenues and expenses.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### Patient Accounts Receivable and Revenues

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. The System is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The System is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG). The System is reimbursed for Medicare and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the System's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. These programs have audited the year-end cost report filed with the Medicare program through December 31, 2006 with differences reflected as deductions from revenue in 2009. During 2009 and 2008, the System recognized approximately \$-0- and \$43,000, respectively, to income due to the differences between original estimates and subsequent revisions for the final settlement of cost reports. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements.

The System has entered into agreements with certain commercial carriers. Reimbursement for services under these agreements includes discounts from established charges and other payment methodologies. Patient charges under these programs, on which no interim payments have been received, are included in patient accounts receivable at the estimated net realizable value of such charges.

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

### Inventory

Inventory is valued at the lower of cost or market with cost being determined on the first-in, first-out (FIFO) method. Inventory consists of medical supplies and pharmaceuticals.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### Assets Whose Use is Limited

Assets whose use is limited are stated at fair value in the consolidated financial statements. These assets include investments designated by the System's Board of Trustees for internal purposes, investments restricted by donors for a specific purpose and investments held by trustees for debt service and capital expenditures. These investments consist primarily of cash and cash equivalents, certificates of deposit, US government securities and mutual funds.

Investment income, to the extent not capitalized, is reported as nonoperating income in the consolidated statements of revenues and expenses.

### Capital Assets and Depreciation

Capital assets such as property and equipment are stated at cost and include expenditures for new additions and other costs added to existing facilities which exceed \$500 and meet certain useful life thresholds. Maintenance, repairs and minor renewals are expensed as incurred. The System provides for depreciation of property and equipment using annual rates, which are sufficient to depreciate the cost of depreciable assets over their estimated useful lives using the straight-line method. The range of useful lives in computing depreciation is as follows:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	15 years
Buildings and fixed equipment	4-50 years
Major moveable equipment	5-15 years

### Net Assets

Net assets of the System are classified in various 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 net assets consist of debt service, capital improvement and other designations and held by the Foundation. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt. Net assets related to non-controlling interest are reported separately on the consolidated balance sheets.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### Consolidated Statements of Revenues and Expenses

The System's consolidated statements of revenues and expenses distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services which is the Hospital's principal activity. Contributions and investment income are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, excluding interest costs.

### Consolidated Statements of Cash Flows

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of 90 days or less from the date of purchase. Capitalized interest expense was approximately \$137,000 and \$275,000 for 2009 and 2008, respectively. Capitalized interest income was approximately \$-0- and \$50,000 for 2009 and 2008, respectively.

### Cost of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

### Bond Issue Costs

The System provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs net of accumulated amortization were \$629,661 and \$618,104 as of December 31, 2009 and 2008, respectively.

### Federal or State Income Taxes

The System is exempt from taxation as a not-for-profit organization under the Internal Revenue Code as an extension of the county government and, therefore, no provision for income taxes has been made.

### Compensated Absences

The System's policy on compensated absences (which include vacation, sick leave and holidays) allows full time employees and regular part time employees to accrue days off, to a maximum of 480 hours. Compensated absences are accrued when incurred and reported as a liability on the consolidated balance sheets.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### Advertising Costs

The System's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were \$798,889 and \$1,081,744 in 2009 and 2008, respectively.

### Litigation

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

### Risk Management

The System is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

### Medical Malpractice Claims

The System participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the System, with the balance paid by the State of Indiana Patient Compensation Fund. The System carries an occurrence basis insurance policy covering the System's \$250,000 of exposure per claim. Accordingly, the System has not recorded any provision of self-insured medical malpractice claims.

### Reclassifications

Certain amounts from the 2008 consolidated financial statements have been reclassified to conform to the current year presentation.

### Subsequent Events

The System evaluates events or transactions occurring subsequent to consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued which is May 27, 2010.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### 2. ACCOUNTING FOR NON-CONTROLLING INTEREST

In 2009, new accounting guidance relative to the presentation of non-controlling interests in financial statements became effective. The System adopted this guidance and reclassified the non-controlling interest as a component of net assets in the consolidated balance sheets and consolidated statements of changes in net assets. In addition, consolidated change in net assets is shown in two components, displaying the portions attributable to both the controlling interest and non-controlling interest, on the consolidated statements of revenues and expenses. The adoption of this pronouncement did not have an effect on consolidated change in net assets for 2008.

### 3. NET PATIENT SERVICE REVENUE

The System has agreements with third-party payors that provide for reimbursement to the System at amounts different from its established rates. Estimated contractual adjustments under third-party reimbursement programs represent the difference between the System's billings at standard rates and amounts reimbursed by third-party payors. They also include any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. A summary of the reimbursement arrangements with major third-party payors is as follows:

#### Medicare

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment Hospital). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment. The System's classification of patients under the Prospective Payment Hospital and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization which is under contract with the System to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### Medicaid

The System is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.

The System is eligible for the Indiana Medicaid Supplemental programs including Medicaid Disproportionate Share Hospital and Municipal Upper Payment Limit programs. The System recognized reimbursement from these programs within net patient revenue of approximately \$3,242,000 and \$1,687,000 during 2009 and 2008, respectively. These programs are Federal programs administered by the state.

### Other Payors

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

The following is a summary of net patient service revenue for 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Inpatient routine services	\$ 38,023,052	\$ 41,114,484
Inpatient ancillary services	85,174,268	79,613,736
Outpatient ancillary services	<u>224,946,627</u>	<u>209,616,317</u>
Gross patient service revenue	348,143,947	330,344,537
Contractual allowance	185,916,805	170,117,330
Charity care	8,723,334	8,199,155
Bad debts	<u>9,790,137</u>	<u>9,859,435</u>
Deductions from revenue	<u>204,430,276</u>	<u>188,175,920</u>
Net patient service revenue	<u>\$ 143,713,671</u>	<u>\$ 142,168,617</u>

The System 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 System does not collect amounts deemed to be charity care, they are not reported as revenue.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### 4. INVESTMENTS

Investments are recorded at fair value and consist of the following as of December 31:

	<u>2009</u>	<u>2008</u>
Cash and cash equivalents	\$ 156,731	\$ 695,812
Mutual funds - equities	9,923,989	7,605,163
Mutual funds - fixed income	9,069,771	7,373,792
	<u>\$ 19,150,491</u>	<u>\$ 15,674,767</u>

### 5. ASSETS WHOSE USE IS LIMITED

The classification of assets whose use is limited includes:

Internally designated - Amounts transferred by the System's Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the System buildings as authorized by IC 16-22-3-13.

Funds held by trustee - System funds deposited with a trustee and limited as to use in accordance with the requirements of a trust indenture for debt service and capital construction.

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. The composition of assets limited as to use includes the following as of December 31:

	<u>2009</u>	<u>2008</u>
Internally designated		
Cash and cash equivalents	\$ 87,921	\$ 397,778
Mutual funds - equities	3,947,096	2,781,751
Mutual funds - fixed income	3,648,193	3,229,522
	<u>7,683,210</u>	<u>6,409,051</u>
Held by trustee		
Cash and cash equivalents	<u>74,877</u>	<u>1,902,142</u>
Total assets whose use is limited	<u>\$ 7,758,087</u>	<u>\$ 8,311,193</u>

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# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

### 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 Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

Investments are generally carried at fair market value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Funded depreciation investments consist of cash equivalents and mutual funds.

The System's investments generally are reported at fair value. As of December 31, 2009 and 2008, the System had the following investments and maturities, all of which were held in the System's name by custodial banks that are agents of the System:

	December 31, 2009				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Mutual funds - equities	\$ 13,871,085	\$ 13,871,085	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	12,717,964	12,717,964	-0-	-0-	-0-
	\$ 26,589,049	\$ 26,589,049	\$ -0-	\$ -0-	\$ -0-

  

	December 31, 2008				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Mutual funds - equities	\$ 10,386,914	\$ 10,386,914	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	10,603,314	10,603,314	-0-	-0-	-0-
	\$ 20,990,228	\$ 20,990,228	\$ -0-	\$ -0-	\$ -0-

Interest rate risk – The System 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 System 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.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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Concentration of credit risk – The System maintains its investments, which at times may exceed federally insured limits. The System has not experienced any losses in such accounts. The System believes that it is not exposed to any significant credit risk on investments.

Deposits and investments consist of the following as of December 31:

	<u>2009</u>	<u>2008</u>
Carrying amount		
Deposits	\$ 12,569,824	\$ 14,933,101
Mutual funds - equities	13,871,085	10,386,914
Mutual funds - fixed income	12,717,964	10,603,314
	<u>\$ 39,158,873</u>	<u>\$ 35,923,329</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 12,250,295	\$ 11,937,369
Investments	19,150,491	15,674,767
Internally designated	7,683,210	6,409,051
Held by trustee	74,877	1,902,142
	<u>\$ 39,158,873</u>	<u>\$ 35,923,329</u>

## 7. FAIR VALUE MEASUREMENTS

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

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

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

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 and 2008 are as follows:

	December 31, 2009			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Investments				
Mutual funds - equities	\$ 9,923,989	\$ 9,923,989	\$ -0-	\$ -0-
Mutual funds - fixed income	9,069,771	9,069,771	-0-	-0-
		<u>\$ 18,993,760</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Cash equivalents	156,731			
Total investments	<u>\$ 19,150,491</u>			
Assets whose use is limited				
Mutual funds - equities	\$ 3,947,096	\$ 3,947,096	\$ -0-	\$ -0-
Mutual funds - fixed income	3,648,193	3,648,193	-0-	-0-
		<u>\$ 7,595,289</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Cash equivalents	162,798			
Total assets whose use is limited	<u>\$ 7,758,087</u>			
<b>Liabilities</b>				
Interest rate swap agreement	<u>\$ 2,756,524</u>	<u>\$ -0-</u>	<u>\$ 2,756,524</u>	<u>\$ -0-</u>
	December 31, 2008			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Investments				
Mutual funds - equities	\$ 7,605,163	\$ 7,605,163	\$ -0-	\$ -0-
Mutual funds - fixed income	7,373,792	7,373,792	-0-	-0-
		<u>\$ 14,978,955</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Cash equivalents	695,812			
Total investments	<u>\$ 15,674,767</u>			
Assets whose use is limited				
Mutual funds - equities	\$ 2,781,751	\$ 2,781,751	\$ -0-	\$ -0-
Mutual funds - fixed income	3,229,522	3,229,522	-0-	-0-
		<u>\$ 6,011,273</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Cash equivalents	2,299,920			
Total assets whose use is limited	<u>\$ 8,311,193</u>			
<b>Liabilities</b>				
Interest rate swap agreement	<u>\$ 8,522,120</u>	<u>\$ -0-</u>	<u>\$ 8,522,120</u>	<u>\$ -0-</u>

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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

Cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements: The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements approximate fair value.

Long term debt: Fair value of the System's variable rate revenue bonds is based on current traded value. The carrying value of loans payable and capital lease obligations approximates fair value.

### 8. CAPITAL ASSETS

A summary of capital assets includes the following as of December 31:

	December 31, 2008	Additions	Retirements	Transfers	December 31, 2009
Land	\$ 1,002,878	\$ -0-	\$ -0-	\$ -0-	\$ 1,002,878
Land improvements	6,467,686	119,571	(32,684)	-0-	6,554,573
Buildings and improvements	93,655,858	552,045	(701,049)	1,871,830	95,378,684
Equipment	63,494,462	1,912,953	(3,855,070)	869,543	62,421,888
Construction in progress	4,223,373	2,392,972	(47,477)	(2,741,373)	3,827,495
Total capital assets	168,844,257	4,977,541	(4,636,280)	-0-	169,185,518
Less accumulated depreciation					
Land improvements	1,446,702	579,849	(31,991)	-0-	1,994,560
Buildings and improvements	37,844,670	3,590,528	(533,255)	-0-	40,901,943
Equipment	40,234,277	5,671,154	(3,629,083)	-0-	42,276,348
Total accumulated depreciation	79,525,649	9,841,531	(4,194,329)	-0-	85,172,851
Capital assets, net	<u>\$ 89,318,608</u>	<u>\$ (4,863,990)</u>	<u>\$ (441,951)</u>	<u>\$ -0-</u>	<u>\$ 84,012,667</u>
	December 31, 2007	Additions	Retirements	Transfers	December 31, 2008
Land	\$ 644,187	\$ -0-	\$ -0-	\$ 358,691	\$ 1,002,878
Land improvements	3,199,230	126,134	(215,667)	3,357,989	6,467,686
Buildings and improvements	79,933,943	870,763	(475,941)	13,327,093	93,655,858
Equipment	50,954,946	2,684,720	(3,752,573)	13,607,369	63,494,462
Construction in progress	16,903,544	6,575,345	(181,860)	(19,073,656)	4,223,373
Total capital assets	151,635,850	10,256,962	(4,626,041)	11,577,486	168,844,257
Less accumulated depreciation					
Land improvements	1,242,579	418,832	(214,709)	-0-	1,446,702
Buildings and improvements	34,676,881	3,340,589	(448,259)	275,459	37,844,670
Equipment	30,785,183	5,917,228	(2,284,752)	5,816,618	40,234,277
Total accumulated depreciation	66,704,643	9,676,649	(2,947,720)	6,092,077	79,525,649
Capital assets, net	<u>\$ 84,931,207</u>	<u>\$ 580,313</u>	<u>\$ (1,678,321)</u>	<u>\$ 5,485,409</u>	<u>\$ 89,318,608</u>

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### 9. LONG TERM DEBT

The System has the following bond issues outstanding with the Indiana Financing Authority (IFA) and other local financial institutions as of December 31, 2009 and 2008:

- 1997 IFA Revenue Bonds, original issue \$6,800,000, was paid in full during 2008.
- 2005 IFA Revenue Bonds (Series 2005 Bonds), original issue \$50,000,000, due through January 2035, variable interest rate of 0.25% as of December 31, 2009, secured by a letter of credit in the amount of approximately \$29,000,000 expiring in August 2010 and a letter of credit in the amount of approximately \$19,000,000 expiring in February 2012. The Series 2005 Bonds require the System to maintain certain financial ratios and restrictive covenants. As of December 31, 2009, the System believes it was in compliance with the financial ratios and covenants.
- 2006 IFA Revenue Bonds, original issue \$1,875,766, due through January 2013, was retired in 2008 and replaced with a loan payable with a local financial institution with a variable interest rate of 5.15% as of December 31, 2009, secured by property.
- Loans payable with local financial institutions, due through 2026 at fixed and variable interest rates ranging from 1.5% to 6.63% as of December 31, 2009, secured by certain System assets.
- Capital lease obligations with interest approximating 5% executed for property and equipment are due in monthly installments of varying amounts from \$14,505 to \$28,557 including interest, due through December 31, 2009. The total cost of the property and equipment under capital leases approximated \$5,600,000 as of December 31, 2009 and 2008 and is listed as security for the obligations. The associated accumulated depreciation approximated \$5,500,000 and \$5,000,000 as of December 31, 2009 and 2008, respectively.

The System has two available letters of credit totaling approximately \$48,000,000 with financial institutions for the Series 2005 Bonds. The letters of credit are intended to provide credit enhancement and liquidity support for the System's tax-exempt bonds. The letters of credit are collateralized by the Hospital's gross revenues as well as designated assets. The letter of credit in the amount of approximately \$29,000,000 expires August 2010 while the letter of credit in the amount of approximately \$19,000,000 expires February 2012. There was no balance outstanding as of December 31, 2009 and 2008.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

In the event of liquidity drawing the System will reimburse the bank in installments through the termination date unless the bonds are remarketed, redeemed or purchased at which time the liquidity advance is due. The liquidity drawing due date for the \$29,000,000 letter of credit is August 2010. The liquidity drawing due date for the \$19,000,000 letter of credit is 367 days after the liquidity drawing. Reimbursements of other than liquidity drawings are due on the date such drawings are honored.

Accounting guidance requires long term debt backed by a letter of credit to be reported as current if the letter of credit does not provide a long term financing option for liquidity drawings. Since the letter of credit in the amount of \$29,000,000 expires in August 2010, this amount from the Series 2005 Bonds is classified as current as of December 31, 2009.

A summary of long term debt for 2009 and 2008 follows:

	December 31, 2008	Transfers/ Borrowings	Payments	December 31, 2009	Current Portion
2005 IFA Revenue Bonds	\$ 48,895,000	\$ -0-	\$ (820,000)	\$ 48,075,000	\$ 855,000
Loans payable	14,504,934	-0-	(1,136,664)	13,368,270	705,245
Capital lease obligations	691,520	-0-	(453,943)	237,577	165,950
Total long term debt	<u>\$ 64,091,454</u>	<u>\$ -0-</u>	<u>\$ (2,410,607)</u>	<u>\$ 61,680,847</u>	1,726,195
Current portion of revenue bonds payable due to letter of credit expiration					<u>29,000,000</u>
Total current portion					<u>\$ 30,726,195</u>

	December 31, 2007	Transfers/ Borrowings	Payments	December 31, 2008	Current Portion
Revenue bonds					
2005 IFA Bonds	\$ 49,695,000	\$ -0-	\$ (800,000)	\$ 48,895,000	\$ 820,000
2006 IFA Bonds	1,325,838	-0-	(1,325,838)	-0-	-0-
Total revenue bonds	51,020,838	-0-	(2,125,838)	48,895,000	820,000
Loans payable	11,756,879	3,516,046	(767,991)	14,504,934	1,042,995
Capital lease obligations	-0-	2,479,936	(1,788,416)	691,520	691,520
Total long term debt	<u>\$ 62,777,717</u>	<u>5,995,982</u>	<u>\$ (4,682,245)</u>	<u>\$ 64,091,454</u>	<u>\$ 2,554,515</u>

The System has interest rate swap agreements related to the Series 2005 Bonds. The interest rate swap agreements do not affect the obligation of the System under the indenture to repay principal and interest on the Series 2005 Bonds. However, during the term of the swap agreements, the System effectively pays a fixed rate on a portion of the debt. A portion of the debt service requirements to maturity for the Series 2005 Bonds are based on that fixed rate. The System will be exposed to variable rates if the counterparty to the swaps defaults or the swap agreements are terminated.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

A termination of the swap agreements may also result in the System making or receiving a termination payment. As of December 31, 2009, the variable rate on the Series 2005 Bonds was lower than the swap agreements fixed rates. Thus, the amounts reported in the interest rate swap, net column of the above table is positive for the difference between the variable rate and swap fixed rate. See the footnote on Derivative Instruments – Interest Rate Swaps for additional information.

Scheduled maturities for the years subsequent to December 31, 2009 are as follows:

Years Ending December 31,	Principal	Interest	Interest Rate Swap, Net	Total
2010	\$ 1,726,195	\$ 823,209	\$ 1,635,893	\$ 4,185,297
2011	2,008,977	768,165	1,607,183	4,384,325
2012	1,927,386	716,704	1,577,483	4,221,573
2013	1,819,362	673,804	1,546,710	4,039,876
2014	1,870,801	634,520	1,514,700	4,020,021
2015-2019	9,124,730	2,572,097	7,052,513	18,749,340
2020-2024	11,032,487	1,350,669	6,063,420	18,446,576
2025-2029	12,910,909	353,291	4,598,798	17,862,998
2030-2034	15,760,000	40,415	1,997,738	17,798,153
2035	3,500,000	130,463	-0-	3,630,463
	<u>\$ 61,680,847</u>	<u>\$ 8,063,337</u>	<u>\$ 27,594,438</u>	<u>\$ 97,338,622</u>

The System has construction contract commitments of approximately \$2 million outstanding as of December 31, 2009.

The System has lines of credit with local financial institutions. The lines bear interest at rates ranging from a fixed rate of 5% to a variable rate of prime less .25% and expire on demand and are collateralized by System assets. There were no borrowings outstanding on the lines of credit as of December 31, 2009 and 2008.

## 10. DERIVATIVE INSTRUMENTS – INTEREST RATE SWAPS

### Objectives and Strategies for Using Derivatives

The System makes limited use of derivative financial instruments for the purpose of managing interest rate risk. In particular, forward interest rate swaps (which are designated as cash flow hedges) are used to manage the risk associated with interest rates on variable-rate borrowing and to lower its overall borrowing costs.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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On October 3, 2005, the System entered into two interest rate swap agreements with a financial institution for a total principal amount of \$40,000,000. The agreements effectively change the System's interest rate exposure on a portion of its issued Series 2005 Bonds to a fixed 3.55%. The agreements expire January 1, 2035. The System is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreements. However, the System does not anticipate nonperformance by the counterparties.

The derivatives are not designated as hedging instruments, and are marked-to-market on the consolidated balance sheets at fair value. As of December 31, 2009 and 2008, the fair value of the total derivative liability was \$2,756,524 and \$8,522,120, respectively. The related gain/loss in the consolidated statements of revenues and expenses is included as a component of nonoperating revenues/expenses for the reporting period. During 2009, the System recorded a gain on derivatives of \$5,765,596 and a loss on derivatives of \$7,659,767 for 2008.

See the Fair Value Measurements and Long Term Debt footnotes for additional information.

### 11. PENSION PLAN

The System has a defined contribution pension plan as authorized by IC 16-22-3-11. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The plan was established by written agreement between the System's Board of Trustees and the plan administrator. The plan administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan. Contact the System's human resource department for information on the plan

Total pension expense for 2009 and 2008 was \$2,634,347 and \$2,413,215, respectively. The current employer contribution rate is 6% of annual covered payroll.

### 12. COMMITMENTS AND CONTINGENCIES

#### Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. Leases expire through 2012. Total rental expense in 2009 and 2008 for all operating leases was \$4,725,160 and \$4,508,242, respectively.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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Minimum payments under non-cancellable operating lease agreements for the years subsequent to December 31, 2009 are as follows:

Years Ending December 31,	
2010	\$ 843,556
2011	577,304
2012	<u>252,036</u>
	<u>\$ 1,672,896</u>

### 13. CONCENTRATIONS

Howard Regional Health System is located in Kokomo, Indiana. The System 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 and revenue from patients and third-party payors as of and for the years ended December 31, 2009 and 2008 was as follows:

	<u>Receivables</u>		<u>Revenues</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Medicare	29%	28%	47%	46%
Medicaid	10%	11%	11%	9%
Blue Cross	13%	17%	20%	25%
Other third party payors	16%	14%	13%	13%
Self-pay	32%	30%	9%	7%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

The blended component units of the System maintain cash in accounts, which at times may exceed federally insured limits. The blended component units have not experienced any losses in such accounts. The blended component units believe that it is not exposed to any significant credit risk on cash and cash equivalents.

### 14. SELF FUNDED HEALTH INSURANCE

The System is self funded for medical and related health benefits provided to employees and their families. A stop/loss policy through commercial insurance covers individual claims in excess of \$150,000 per year with an overall aggregate of \$1,000,000. Provisions are made for unexpected and unusual claims.

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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Claim expenditures and liabilities 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. Self funded health insurance and related expenses were \$6,768,466 and \$6,728,334 in 2009 and 2008, respectively. A progression of unpaid claims for 2009 and 2008 follows:

	<u>2009</u>	<u>2008</u>
Unpaid claims, beginning of year	\$ 1,055,318	\$ 1,162,889
Incurred claims and changes in estimates	6,768,466	6,728,334
Claim payments	<u>(6,754,561)</u>	<u>(6,835,905)</u>
Unpaid claims, end of year	<u>\$ 1,069,223</u>	<u>\$ 1,055,318</u>

### 15. INVESTMENTS IN AFFILIATED COMPANIES

#### North Central Indiana Linen Service, Inc.

The System owns 33% of North Central Indiana Linen Service. The investment is accounted for under the equity method. Summarized financial information as of December 31 follows:

	<u>2009</u>	<u>2008</u>
Assets	\$ 1,192,049	\$ 1,139,875
Liabilities	\$ 207,722	\$ 164,572
Equity	\$ 984,327	\$ 975,303
Revenue	\$ 1,394,421	\$ 1,560,461
Expenses	\$ 1,385,397	\$ 1,458,519
Net income	\$ 9,024	\$ 101,942

# HOWARD REGIONAL HEALTH SYSTEM

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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### 16. STATE AND LOCAL AWARDS

During 2009 and 2008, the System recorded the following state and local awards:

<u>Grantor</u>	<u>Grant Identification</u>	<u>2009 Expenditures</u>	<u>2008 Expenditures</u>
Indiana Division of Mental Health and Addiction & Affiliated Service Providers of Indiana Managed care provider agreement	A55-9-34-09-HO-2710	\$ 2,174,261	\$ 1,283,432
Indiana State Department of Health Community Health Centers	A70-7-7957	137,742	136,630
Tipton County	Not applicable	87,877	84,497
Clinton County	Not applicable	151,418	145,594
Howard County	Not applicable	583,666	561,217
Total state and local awards		<u>\$ 3,134,964</u>	<u>\$ 2,211,370</u>

State and local awards are reported in the consolidated statements of revenues and expenses under other revenue.

**SUPPLEMENTARY INFORMATION**

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2009

ASSETS	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
<b>Current assets</b>								
Cash and cash equivalents	\$ 8,352,860	\$ 771,828	\$ 1,181,917	\$ 67,662	\$ 1,638,313	\$ 237,715	\$ -0-	\$ 12,250,295
Investments	16,811,397	2,339,094	-0-	-0-	-0-	-0-	-0-	19,150,491
Patient accounts receivable, net	18,717,611	-0-	1,069,121	-0-	-0-	177,313	-0-	19,964,045
Other receivables	3,823,725	61,851	3,597	14,060	1,243,254	-0-	(2,576,237)	2,570,250
Inventory and other current assets	5,474,017	-0-	291,816	11,012	449,280	32,605	-0-	6,258,730
Estimated third party settlements	200,909	-0-	-0-	-0-	-0-	-0-	-0-	200,909
Current portion of assets whose use is limited	7,683,210	-0-	-0-	-0-	-0-	-0-	-0-	7,683,210
Total current assets	61,063,729	3,172,773	2,546,451	92,734	3,330,847	447,633	(2,576,237)	68,077,930
<b>Assets whose use is limited</b>								
Internally designated	7,683,210	-0-	-0-	-0-	-0-	-0-	-0-	7,683,210
Held by trustee	-0-	74,877	-0-	-0-	-0-	-0-	-0-	74,877
Total assets whose use is limited	7,683,210	74,877	-0-	-0-	-0-	-0-	-0-	7,758,087
Less current portion of assets whose use is limited	7,683,210	-0-	-0-	-0-	-0-	-0-	-0-	7,683,210
Noncurrent portion of assets whose use is limited	-0-	74,877	-0-	-0-	-0-	-0-	-0-	74,877
<b>Capital assets, net</b>	79,005,685	187	599,566	684,969	527,845	3,194,415	-0-	84,012,667
<b>Other assets</b>	4,823,511	830,066	730,370	-0-	-0-	-0-	(4,616,198)	1,767,749
Total assets	<u>\$ 144,892,925</u>	<u>\$ 4,077,903</u>	<u>\$ 3,876,387</u>	<u>\$ 777,703</u>	<u>\$ 3,858,692</u>	<u>\$ 3,642,048</u>	<u>\$ (7,192,435)</u>	<u>\$ 153,933,223</u>

See report of independent auditors on pages 1 and 2.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2009

LIABILITIES AND NET ASSETS	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
<b>Current liabilities</b>								
Accounts payable and accrued expenses	\$ 2,877,304	\$ -0-	\$ 428,141	\$ 1,306,203	\$ 643,514	\$ 724,416	\$ (2,437,926)	\$ 3,541,652
Accrued liabilities	7,385,608	-0-	403,941	-0-	-0-	47,253	-0-	7,836,802
Other current liabilities	724,300	101,523	118,540	119,371	-0-	-0-	(101,311)	962,423
Current portion of loans payable	441,834	-0-	-0-	-0-	-0-	300,996	(37,585)	705,245
Current portion of capital lease payable	263,143	-0-	-0-	-0-	-0-	165,950	(263,143)	165,950
Current portion of revenue bonds payable	855,000	-0-	-0-	-0-	-0-	-0-	-0-	855,000
Current portion of revenue bonds payable due to letter of credit expiration	29,000,000	-0-	-0-	-0-	-0-	-0-	-0-	29,000,000
Total current liabilities	<u>41,547,189</u>	<u>101,523</u>	<u>950,622</u>	<u>1,425,574</u>	<u>643,514</u>	<u>1,238,615</u>	<u>(2,839,965)</u>	<u>43,067,072</u>
<b>Long term debt</b>								
Loans payable	10,584,290	773,533	-0-	37,000	-0-	1,270,778	(2,576)	12,663,025
Capital lease payable	507,229	-0-	-0-	-0-	-0-	71,627	(507,229)	71,627
Revenue bonds payable	18,220,000	-0-	-0-	-0-	-0-	-0-	-0-	18,220,000
Total long term debt	<u>29,311,519</u>	<u>773,533</u>	<u>-0-</u>	<u>37,000</u>	<u>-0-</u>	<u>1,342,405</u>	<u>(509,805)</u>	<u>30,954,652</u>
<b>Other long term liabilities</b>	<u>2,756,524</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>2,756,524</u>
Total liabilities	<u>73,615,232</u>	<u>875,056</u>	<u>950,622</u>	<u>1,462,574</u>	<u>643,514</u>	<u>2,581,020</u>	<u>(3,349,770)</u>	<u>76,778,248</u>
<b>Net assets</b>								
Invested in capital assets, net of related debt	19,134,189	(773,346)	599,566	647,969	527,845	1,385,064	810,533	22,331,820
Restricted								
For debt service	-0-	74,877	-0-	-0-	-0-	-0-	-0-	74,877
Expendable for capital improvements	7,683,210	-0-	-0-	-0-	-0-	-0-	-0-	7,683,210
Expendable for other specific purposes	10,885	-0-	-0-	-0-	-0-	-0-	-0-	10,885
Held by Foundation	-0-	3,202,847	-0-	-0-	-0-	-0-	-0-	3,202,847
Total restricted net assets	<u>7,694,095</u>	<u>3,277,724</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>10,971,819</u>
Unrestricted	<u>44,449,409</u>	<u>698,469</u>	<u>2,326,199</u>	<u>(1,332,840)</u>	<u>2,687,333</u>	<u>(324,036)</u>	<u>(7,127,502)</u>	<u>41,377,032</u>
Net assets - controlling interest	71,277,693	3,202,847	2,925,765	(684,871)	3,215,178	1,061,028	(6,316,969)	74,680,671
Non-controlling interest	-0-	-0-	-0-	-0-	-0-	-0-	2,474,304	2,474,304
Total net assets	<u>71,277,693</u>	<u>3,202,847</u>	<u>2,925,765</u>	<u>(684,871)</u>	<u>3,215,178</u>	<u>1,061,028</u>	<u>(3,842,665)</u>	<u>77,154,975</u>
Total liabilities and net assets	<u>\$ 144,892,925</u>	<u>\$ 4,077,903</u>	<u>\$ 3,876,387</u>	<u>\$ 777,703</u>	<u>\$ 3,858,692</u>	<u>\$ 3,642,048</u>	<u>\$ (7,192,435)</u>	<u>\$ 153,933,223</u>

See report of independent auditors on pages 1 and 2.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATING STATEMENTS OF REVENUES AND EXPENSES YEAR ENDED DECEMBER 31, 2009

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
<b>Revenues</b>								
Net patient service revenue	\$ 117,293,528	\$ -0-	\$ 13,451,256	\$ -0-	\$ 10,211,110	\$ 2,757,777	\$ -0-	\$ 143,713,671
Other	14,080,938	50,172	894,901	453,612	-0-	17,885	(1,344,151)	14,153,357
Total revenues	<u>131,374,466</u>	<u>50,172</u>	<u>14,346,157</u>	<u>453,612</u>	<u>10,211,110</u>	<u>2,775,662</u>	<u>(1,344,151)</u>	<u>157,867,028</u>
<b>Operating expenses</b>								
Salaries and wages	53,612,778	-0-	7,323,380	-0-	2,978,090	676,892	-0-	64,591,140
Employee benefits	12,756,588	-0-	1,839,476	-0-	-0-	32,500	-0-	14,628,564
Medical professional fees	4,708,257	-0-	686,653	21,720	-0-	310,747	-0-	5,727,377
Medical supplies and drugs	24,135,446	-0-	832,536	34,676	2,409,567	157,956	-0-	27,570,181
Purchased services	8,430,954	-0-	757,514	458,183	426,753	231,319	(234,228)	10,070,495
Equipment rentals	6,395,439	-0-	1,100,913	17,757	1,036,019	764,357	(1,059,945)	8,254,540
Utilities and telephone	2,454,050	-0-	364,154	44,804	61,616	126,352	-0-	3,050,976
Insurance	987,836	-0-	69,923	10,773	37,503	45,690	-0-	1,151,725
Depreciation and amortization	8,886,429	-0-	215,833	87,405	207,063	512,577	-0-	9,909,307
Other	8,835,153	-0-	146,522	73,531	247,203	105,221	-0-	9,407,630
Total expenses	<u>131,202,930</u>	<u>-0-</u>	<u>13,336,904</u>	<u>748,849</u>	<u>7,403,814</u>	<u>2,963,611</u>	<u>(1,294,173)</u>	<u>154,361,935</u>
Operating income (loss)	171,536	50,172	1,009,253	(295,237)	2,807,296	(187,949)	(49,978)	3,505,093
<b>Nonoperating revenues (expenses)</b>								
Investment income	4,261,056	547,373	-0-	0	6,831	8	-0-	4,815,268
Interest expense	(3,161,009)	-0-	-0-	(109)	-0-	(55,002)	49,978	(3,166,142)
Unrealized gain on derivatives	5,765,596	-0-	-0-	-0-	-0-	-0-	-0-	5,765,596
Other nonoperating revenues (expenses)	1,310,387	(306,576)	9,546	-0-	-0-	233,978	(1,890,735)	(643,400)
Nonoperating revenues (expenses), net	<u>8,176,030</u>	<u>240,797</u>	<u>9,546</u>	<u>(109)</u>	<u>6,831</u>	<u>178,984</u>	<u>(1,840,757)</u>	<u>6,771,322</u>
<b>Consolidated change in net assets</b>	8,347,566	290,969	1,018,799	(295,346)	2,814,127	(8,965)	(1,890,735)	10,276,415
Less amount attributable to non-controlling interest	-0-	-0-	-0-	-0-	-0-	-0-	(1,721,258)	(1,721,258)
Change in net assets attributable to controlling interest	<u>\$ 8,347,566</u>	<u>\$ 290,969</u>	<u>\$ 1,018,799</u>	<u>\$ (295,346)</u>	<u>\$ 2,814,127</u>	<u>\$ (8,965)</u>	<u>\$ (3,611,993)</u>	<u>\$ 8,555,157</u>

See report of independent auditors on pages 1 and 2.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2008

ASSETS	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
<b>Current assets</b>								
Cash and cash equivalents	\$ 8,474,642	\$ 1,025,376	\$ 1,280,111	\$ 93,326	\$ 1,063,743	\$ 171	\$ -0-	\$ 11,937,369
Investments	13,851,390	1,823,377	-0-	-0-	-0-	-0-	-0-	15,674,767
Patient accounts receivable, net	19,575,388	-0-	1,338,089	-0-	-0-	218,632	-0-	21,132,109
Other receivables	3,213,723	41,067	14,860	14,010	1,414,453	5,329	(1,646,600)	3,056,842
Inventory and other current assets	5,162,377	-0-	213,445	-0-	347,089	32,709	-0-	5,755,620
Estimated third party settlements	122,728	-0-	-0-	-0-	-0-	-0-	-0-	122,728
Current portion of assets whose use is limited	820,000	-0-	-0-	-0-	-0-	-0-	-0-	820,000
Total current assets	51,220,248	2,889,820	2,846,505	107,336	2,825,285	256,841	(1,646,600)	58,499,435
<b>Assets whose use is limited</b>								
Internally designated	6,409,051	-0-	-0-	-0-	-0-	-0-	-0-	6,409,051
Held by trustee	1,835,033	67,109	-0-	-0-	-0-	-0-	-0-	1,902,142
Total assets whose use is limited	8,244,084	67,109	-0-	-0-	-0-	-0-	-0-	8,311,193
Less current portion of assets whose use is limited	820,000	-0-	-0-	-0-	-0-	-0-	-0-	820,000
Noncurrent portion of assets whose use is limited	7,424,084	67,109	-0-	-0-	-0-	-0-	-0-	7,491,193
<b>Capital assets, net</b>	84,056,906	289	645,562	705,483	535,333	3,375,035	-0-	89,318,608
<b>Other assets</b>	4,814,872	1,239,564	798,146	-0-	-0-	-0-	(4,465,426)	2,387,156
Total assets	<u>\$ 147,516,110</u>	<u>\$ 4,196,782</u>	<u>\$ 4,290,213</u>	<u>\$ 812,819</u>	<u>\$ 3,360,618</u>	<u>\$ 3,631,876</u>	<u>\$ (6,112,026)</u>	<u>\$ 157,696,392</u>

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# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2008

LIABILITIES AND NET ASSETS	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
<b>Current liabilities</b>								
Accounts payable and accrued expenses	\$ 3,734,279	\$ -0-	\$ 429,208	\$ 1,065,826	\$ 621,566	\$ 120,278	\$ (1,502,532)	\$ 4,468,625
Accrued liabilities and other	9,476,453	-0-	719,250	-0-	-0-	77,763	-0-	10,273,466
Other current liabilities	1,380,319	174,100	129,789	99,518	-0-	47,151	(205,773)	1,625,104
Current portion of loans payable	417,241	241,312	-0-	-0-	-0-	384,442	-0-	1,042,995
Current portion of capital lease payable	273,312	-0-	-0-	-0-	-0-	659,520	(241,312)	691,520
Current portion of revenue bonds payable	820,000	-0-	-0-	-0-	-0-	-0-	-0-	820,000
Total current liabilities	16,101,604	415,412	1,278,247	1,165,344	621,566	1,289,154	(1,949,617)	18,921,710
<b>Long term debt</b>								
Loans payable	11,019,717	869,493	-0-	37,000	-0-	1,572,729	(37,000)	13,461,939
Capital lease payable	867,547	-0-	-0-	-0-	-0-	-0-	(867,547)	-0-
Revenue bonds payable	48,075,000	-0-	-0-	-0-	-0-	-0-	-0-	48,075,000
Total long term debt	59,962,264	869,493	-0-	37,000	-0-	1,572,729	(904,547)	61,536,939
<b>Other long term liabilities</b>	8,522,120	-0-	-0-	-0-	-0-	-0-	-0-	8,522,120
Total liabilities	84,585,988	1,284,905	1,278,247	1,202,344	621,566	2,861,883	(2,854,164)	88,980,769
<b>Net assets</b>								
Invested in capital assets, net of related debt	22,584,089	(1,110,516)	645,562	668,483	535,333	758,344	1,145,859	25,227,154
Restricted								
For debt service	1,835,033	67,109	-0-	-0-	-0-	-0-	-0-	1,902,142
Expendable for capital improvements	6,409,051	-0-	-0-	-0-	-0-	-0-	-0-	6,409,051
Expendable for other specific purposes	10,885	-0-	-0-	-0-	-0-	-0-	-0-	10,885
Held by Foundation	-0-	2,911,877	-0-	-0-	-0-	-0-	-0-	2,911,877
Total restricted net assets	8,254,969	2,978,986	-0-	-0-	-0-	-0-	-0-	11,233,955
Unrestricted	32,091,064	1,043,407	2,366,404	(1,058,008)	2,203,719	11,649	(6,993,830)	29,664,405
Net assets - controlling interest	62,930,122	2,911,877	3,011,966	(389,525)	2,739,052	769,993	(5,847,971)	66,125,514
Non-controlling interest	-0-	-0-	-0-	-0-	-0-	-0-	2,590,109	2,590,109
Total net assets	62,930,122	2,911,877	3,011,966	(389,525)	2,739,052	769,993	(3,257,862)	68,715,623
Total liabilities and net assets	\$ 147,516,110	\$ 4,196,782	\$ 4,290,213	\$ 812,819	\$ 3,360,618	\$ 3,631,876	\$ (6,112,026)	\$ 157,696,392

See report of independent auditors on pages 1 and 2.

# HOWARD REGIONAL HEALTH SYSTEM

## CONSOLIDATING STATEMENTS OF REVENUES AND EXPENSES YEAR ENDED DECEMBER 31, 2008

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Eliminations	Total
<b>Revenues</b>								
Net patient service revenue	\$ 117,095,201	\$ -0-	\$ 13,832,235	\$ -0-	\$ 10,156,164	\$ 2,955,869	\$ (1,870,852)	\$ 142,168,617
Other	13,171,939	228,386	924,453	486,520	394,677	1,815	(1,058,229)	14,149,561
Total revenues	130,267,140	228,386	14,756,688	486,520	10,550,841	2,957,684	(2,929,081)	156,318,178
<b>Operating expenses</b>								
Salaries and wages	56,993,876	-0-	7,388,390	-0-	2,991,495	775,511	-0-	68,149,272
Employee benefits	12,830,903	-0-	1,853,493	-0-	-0-	53,107	-0-	14,737,503
Medical professional fees	3,426,464	-0-	583,034	23,662	-0-	483,355	-0-	4,516,515
Medical supplies and drugs	25,300,927	-0-	930,059	32,204	2,453,869	207,764	-0-	28,924,823
Purchased services	9,311,093	-0-	842,512	466,519	500,820	152,963	(2,105,080)	9,168,827
Equipment rentals	6,635,393	-0-	1,168,442	29,186	1,024,854	705,409	(1,051,170)	8,512,114
Utilities and telephone	2,504,673	-0-	345,276	44,260	63,511	95,216	-0-	3,052,936
Insurance	1,055,928	-0-	63,485	12,146	38,218	49,132	-0-	1,218,909
Depreciation and amortization	8,350,220	-0-	212,493	77,913	197,764	906,035	-0-	9,744,425
Other	9,319,072	-0-	251,925	64,478	324,322	115,711	-0-	10,075,508
Total expenses	135,728,549	-0-	13,639,109	750,368	7,594,853	3,544,203	(3,156,250)	158,100,832
Operating income (loss)	(5,461,409)	228,386	1,117,579	(263,848)	2,955,988	(586,519)	227,169	(1,782,654)
<b>Nonoperating revenues (expenses)</b>								
Investment income	(6,351,677)	(743,505)	-0-	1,395	54,795	9,528	-0-	(7,029,464)
Interest expense	(2,880,319)	-0-	-0-	(375)	-0-	(235,478)	(227,169)	(3,343,341)
Unrealized loss on derivatives	(7,659,767)	-0-	-0-	-0-	-0-	-0-	-0-	(7,659,767)
Other nonoperating revenues (expenses)	274,649	(106,789)	(4,215)	(29,278)	-0-	(337,244)	(531,709)	(734,586)
Nonoperating revenues (expenses), net	(16,617,114)	(850,294)	(4,215)	(28,258)	54,795	(563,194)	(758,878)	(18,767,158)
<b>Consolidated change in net assets</b>	(22,078,523)	(621,908)	1,113,364	(292,106)	3,010,783	(1,149,713)	(531,709)	(20,549,812)
Less amount attributable to non-controlling interest	-0-	-0-	-0-	-0-	-0-	-0-	(1,867,104)	(1,867,104)
Change in net assets attributable to controlling interest	\$ (22,078,523)	\$ (621,908)	\$ 1,113,364	\$ (292,106)	\$ 3,010,783	\$ (1,149,713)	\$ (2,398,813)	\$ (22,416,916)

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