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June 17, 2011

Board of Directors
Floyd Memorial Hospital and Health Services
1850 State Street
New Albany, IN 47150

We have reviewed the audit report prepared by BKD, LLP, Independent Public Accountants, for the period January 1, 2010 to December 31, 2010. 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 Floyd Memorial Hospital and Health Services, as of December 31, 2010 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

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Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana

Accountants' Report and Financial Statements

December 31, 2010 and 2009

BKD LLP
CPAs & Advisors

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
December 31, 2010 and 2009

Contents

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CPAs & Advisors

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees
Floyd Memorial Hospital and Health Services
New Albany, Indiana

We have audited the accompanying balance sheets of Floyd Memorial Hospital and Health Services (Hospital) a component unit of Floyd County, Indiana, as of December 31, 2010 and 2009, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Floyd Memorial Foundation, Inc. which is discretely presented in the financial statements and whose statements reflect total assets of $4,140,696 as of December 31, 2009, and total revenues of $1,158,009 for the year then ended. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Floyd Memorial Foundation, Inc., is based on the report of the other auditors.

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

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

As discussed in Note 19, in 2010 the Hospital changed its method of accounting for derivative instruments by retroactively restating prior years' financial statements.

The accompanying management's discussion and analysis and pension information as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. 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.

BKD, LLP

March 29, 2011

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Management's Discussion and Analysis
Years Ended December 31, 2010 and 2009

Introduction

This management's discussion and analysis of the financial performance of Floyd Memorial Hospital and Health Services (Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2010 and 2009. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and investments, excluding amounts held by trustee for debt service, increased by $2,469,902, or 2.9% in 2010 as compared to 2009 and by $11,118,818, or 14.7% in 2009 as compared to 2008.
- The Hospital's net assets increased in the past year by $3,602,922, or 2.9% as compared to 2009 when the Hospital's net assets increased by $7,182,685, or 6.1%.
- The Hospital reported operating gains in 2010 of $5,447,870, or 2.6% of total operating revenues vs. $6,371,481, or 3.4% of total operating revenues in 2009 and $11,012,797, or 6.3% of total operating revenues in 2008.
- Net nonoperating revenues decreased by $2,668,567 in 2010 as compared to 2009 and increased $8,593,814 in 2009 as compared to 2008.
- Days cash on hand decreased to 169 in 2010 from 189 in 2009 and 185 in 2008.
- Debt service coverage ratio deteriorated to 2.6 in 2010 from 3.2 in 2009 and 4.1 in 2008.

Using This Annual Report

The Hospital's financial statements consist of three statements — a balance sheet, statement of revenues, expenses and changes in net assets and statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital reports as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets

The balance sheet and the statement of revenues, expenses and changes in net assets report information about the Hospital's resources and activities for purposes of illustrating the effects of the past year's activity on the financial health of the institution. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. As the Hospital uses the accrual basis of accounting, current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Hospital's total net assets — 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. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. The statement of cash flows illustrates the uses and sources of cash for the year.

The Hospital's Net Assets

The Hospital's net assets are the difference between assets and liabilities reported in the balance sheet. The Hospital's net assets increased by $3,602,922, or 2.9% in 2010 vs. 2009 and by $7,182,685, or 6.6% in 2009 vs. 2008, as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2010	2009	2008
Assets			
Patient accounts receivable, net	$ 26,885,624	$ 21,854,930	$ 19,349,926
Other current assets	31,450,765	55,977,578	48,806,334
Capital assets, net	122,675,037	123,633,667	129,032,856
Deferred outflow of resources - interest rate swap agreements	6,103,182	9,428,762	20,476,224
Other noncurrent assets	80,715,271	48,329,931	44,579,860
Total assets	$ 267,829,879	$ 259,224,868	$ 262,245,200
Liabilities			
Long-term debt	$ 92,418,394	$ 92,437,307	$ 94,810,675
Other current and noncurrent liabilities	41,267,523	32,920,941	29,703,128
Fair value of interest rate swap agreements	6,103,182	9,428,762	20,476,224
Total liabilities	139,789,099	134,787,010	144,990,027

	2010	2009	2008
Net Assets			
Invested in capital assets, net of related debt	$ 27,745,057	$ 28,649,756	$ 31,892,639
Restricted expendable	7,189,238	2,671,791	3,013,565
Unrestricted	93,106,485	93,116,311	82,348,969
Total net assets	128,040,780	124,437,858	117,255,173
Total liabilities and net assets	$ 267,829,879	$ 259,224,868	$ 262,245,200

Patient accounts receivable increased by $5,030,694, or 23% from 2009 to 2010, primarily driving the increase in Hospital assets for the same period. This increase is attributable to the acquisition of the Cancer Care Center.

Operating Results and Changes in the Hospital's Net Assets

In 2010, the Hospital's net assets increased by $3,602,922, or 2.9%, as shown in Table 2. This increase is made up of several different components as shown in Table 2 and represents a significant change when compared with the increase in net assets of $7,182,685, or 6.6% in 2009.

Table 2: Operating Results and Changes in Net Assets

	2010	2009	2008
Operating Revenues			
Net patient service revenue	$ 206,270,477	$ 183,461,992	$ 171,499,864
Other operating revenues	2,853,863	2,909,713	2,672,905
Total operating revenues	209,124,340	186,371,705	174,172,769
Operating Expenses			
Salaries and wages and employee benefits	103,589,346	92,363,172	83,819,553
Purchased services and professional fees	24,886,596	22,864,845	16,802,545
Depreciation and amortization	11,607,832	12,328,768	13,413,131
Other operating expenses	63,592,696	52,443,439	49,124,743
Total operating expenses	203,676,470	180,000,224	163,159,972
Operating Income	5,447,870	6,371,481	11,012,797

	2010	2009	2008
Nonoperating Revenues (Expenses)			
Investment income	$ 1,900,812	$ 4,392,714	$ (2,774,068)
Noncapital grants and contributions	392,997	546,479	291,548
Interest expense	(4,859,949)	(4,257,535)	(5,594,526)
Other nonoperating revenues and expenses, net	699,917	120,686	285,576
Total nonoperating revenues (expenses)	(1,866,223)	802,344	(7,791,470)
Capital Grants			
Capital grants	21,275	8,860	112,004
Total capital grants	21,275	8,860	112,004
Change in Net Assets	$ 3,602,922	$ 7,182,685	$ 3,333,331

Operating Income (Loss)

The first component of the overall change in the Hospital's net assets is its operating income or loss, identified as the difference between net patient service and other operating revenues and the expenses incurred to perform those services.

The operating income for 2010 was $5,447,870 as compared to an operating income of $6,371,481 for 2009 and $11,012,797 for 2008. The primary components of change in operating results are:

- An increase in net patient service revenue of $22,808,485, or 12.4% in 2010 due to the acquisition of the Cancer Care Center and additional physician practices.
- An increase in salaries and benefits for the Hospital's employees of $11,226,174, or 12.2% in 2010 as compared to an increase of $8,543,619, or 10.2% in 2009.
- An increase in medical supply and drug costs of $10,462,028, or 25.9% in 2010 and $1,956,890, or 5.1% in 2009.
- A decrease in depreciation and amortization of $720,936, or 5.9% in 2010 and $1,084,363, or 8.1% in 2009.

Net patient service revenue increased by 12.4% due to an increase in patient days of 6.8% from 2009 to 2010, an approximate 4.4% charge increase and the acquisition of the Cancer Care Center. In 2009, net patient service revenue increased by 7.0% due to an increase in patient days of 3.8% from 2008 to 2009 and a 6.5% charge increase. In 2010, the net patient service revenue increase was driven by a 1.4% increase in inpatient discharges and a 10.6% increase in outpatient visits from 2009. Net patient service revenue was also positively impacted by revenue cycle initiatives yielding revenue enhancements of $6.1 million in 2010.

Full-time equivalent employees increased to 1,607 in 2010, or 9.3% from 1,471 in 2009 and 1,380, or 6.6% in 2008. The 2010 increase is primarily due to the addition of staff as the result of the Cancer Care Center, physician practices and physical therapy practice acquisitions along with increased staffing for the addition of monitored beds. The 2009 increase in staffing represented the funding of positions to support revenue cycle and supply chain initiatives and to improve nurse to patient ratios.

The rate of health care inflation has a direct effect on the cost of services provided by the Hospital. Expenditures for medical supplies and prescription drugs are a major component of the Hospital's costs. In 2010, the costs totaled $50,932,923, or 25.0% of total operating expenses, resulting in an increase of $10,462,028, or 25.9% over 2009. In 2009, the costs totaled $40,470,895, or 22.4% of total operating expenses, resulting in an increase of $1,956,890, or 5.1% over 2008. In 2008, the costs totaled $38,514,005, or 23.6% of total operating expenses, for an increase of $754,368, or 2.0% over 2007. Some of the major factors contributing to the increased medical supply and drug costs include an aging population, increase in the complexity of patient cases, increase in cardiac procedures, the introduction of new drugs that cannot be obtained in generic form, changes in therapeutic mix and pharmaceutical marketing. In 2008, the Hospital implemented a clinical quality value analysis (CQVA) program, focused on the quality and cost-effectiveness of supplies. The CQVA program yielded savings of approximately $1.1 million in 2010 compared to approximately $1.6 million in 2009.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income and interest expense. The Hospital recorded realized investment losses of $21 in 2010 vs. gains of $503,989 in 2009. In 2010, the Hospital recorded unrealized investment gains of $960,786 vs. $2,625,066 in 2009. Interest expense increased to $4,859,949 in 2010, or a 14% increase over 2009 due to the issuance of the 2010 bonds and prevailing market interest rates associated with the 2008 bonds.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with improvements in operating income. Unrealized losses related to investments and the swap agreements do not impact cash balances.

Capital Asset and Debt Administration

Capital Assets

At the end of 2010, the Hospital had $122,675,037 invested in capital assets, net of accumulated depreciation compared to $123,633,667 in 2009; this decrease of $985,630 from 2009 is the result of numerous assets reaching full depreciation in 2009 coupled with recording the retirement of assets no longer in use. The decrease of $5,399,189 from 2009 to 2008 was primarily due to management of capital expenditures.

Debt

At December 31, 2010, the Hospital had $105,036,586 in revenue bonds and capital lease obligations outstanding.

In April 2010, the Hospital participated in the issuance of $56,570,000 Indiana Health Facility Financing Authority Hospital Refunding Revenue Bonds, Series 2010 Bonds (2010 Bonds), which bear interest at rates ranging from 3.000% to 5.375%. The proceeds were primarily used for the advanced refunding of the 1998 and 2003 B bonds and the termination of the 2003 B interest rate swap agreement.

Other Operating and Future Economic Factors

Indiana Medicaid Disproportionate Share Hospital (DSH) Payment Program

The DSH program (which involves inter-governmental transfers with significant matching federal dollars) has experienced additional scrutiny from the Centers for Medicare and Medicaid Services (CMS, or commonly referred to as Medicare) and our nation's congressional leaders, which creates challenges in estimating the level of expected payments from the Indiana Medicaid DSH program. It is reasonably possible estimates associated with the DSH program could change materially in the near term.

Effective January 1, 2008, the state of Indiana began operating an insurance plan for the benefit of Indiana residents without health insurance. The plan, referred to as the Healthy Indiana Plan (HIP), is funded through an additional state cigarette tax and with the use of a portion of the DSH funds described above. As such, the level of future DSH payments may also be negatively affected.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the chief financial officer by telephoning 812.948.7402.

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Balance Sheets
December 31, 2010 and 2009

Assets

	2010	2009
Current Assets		
Cash and cash equivalents	$ 22,800,889	$ 49,049,956
Restricted investments - current	1,821,978	1,076,230
Patient accounts receivable, net of allowance; 2010 - $14,788,614, 2009 - $15,035,994	26,885,624	21,854,930
Supplies	3,886,789	2,872,649
Prepaid expenses and other current assets	2,941,109	2,978,743
Total current assets	58,336,389	77,832,508
Noncurrent Cash and Investments		
Internally designated	66,376,910	37,657,941
Held by trustee for debt service	7,189,238	2,671,791
	73,566,148	40,329,732
Less amount required to meet current obligations	1,821,978	1,076,230
	71,744,170	39,253,502
Capital Assets, Net	122,675,037	123,633,667
Deferred Outflow of Resources - Interest Rate Swap Agreements	6,103,182	9,428,762
Other Assets		
Other	8,971,101	9,076,429
Total assets	$ 267,829,879	$ 259,224,868

See Notes to Financial Statements

Liabilities and Net Assets

	2010	2009
Current Liabilities		
Current maturities of long-term debt	$ 2,511,586	$ 2,546,604
Payable to suppliers and contractors	9,340,318	6,486,378
Payable to employees (including payroll taxes and benefits)	10,599,238	9,183,304
Estimated amounts due to third-party payers	3,241,717	1,876,518
Accrued expenses	2,517,924	1,637,827
Payable to Northgate Surgery Center	458,016	459,490
Total current liabilities	28,668,799	22,190,121
Fair Value of Interest Rate Swap Agreements	6,103,182	9,428,762
Long-term Debt	92,418,394	92,437,307
Accrued Pension and Other Long-term Liabilities	12,598,724	10,730,820
Total liabilities	139,789,099	134,787,010
Net Assets		
Invested in capital assets, net of related debt	27,745,057	28,649,756
Restricted-expendable for debt service	7,189,238	2,671,791
Unrestricted	93,106,485	93,116,311
Total net assets	128,040,780	124,437,858
Total liabilities and net assets	$ 267,829,879	$ 259,224,868

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Floyd Memorial Foundation, Inc.
Statement of Financial Position
December 31, 2009

Assets

Current Assets		
Cash and cash equivalents	$	433,967
Pledges receivable, current portion		50,285
Interest receivable		9,208
Total current assets		493,460
Investments		3,482,951
Other Assets		
Pledges receivable, net of current portion		79,404
Cash surrender value of life insurance		84,881
		164,285
Total assets	$	4,140,696

Liabilities and Net Assets

Current Liabilities		
Grant payable	$	150,823
Total current liabilities		150,823
Net Assets		
Unrestricted		3,683,694
Temporarily restricted		295,009
Permanantly restricted		11,170
Total net assets		3,989,873
Total liabilities and net assets	$	4,140,696

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2010 and 2009

	2010	2009
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2010 - $22,741,489, 2009 - $21,994,338	$ 206,270,477	$ 183,461,992
Other	2,853,863	2,909,713
Total operating revenues	209,124,340	186,371,705
Operating Expenses		
Salaries and benefits	103,589,346	92,363,172
Purchased services and professional fees	24,886,596	22,864,845
Supplies	50,932,923	40,470,895
Other expenses	12,609,141	11,705,497
Depreciation and amortization	11,607,832	12,328,768
Loss on sale of property and equipment	50,632	267,047
Total operating expenses	203,676,470	180,000,224
Operating Income	5,447,870	6,371,481
Nonoperating Revenues (Expenses)		
Investment income	1,900,812	4,392,714
Interest expense	(4,859,949)	(4,257,535)
Noncapital grants and contributions	392,997	546,479
Gain on investment in equity investees	699,917	120,686
Total nonoperating revenues (expenses)	(1,866,223)	802,344
Excess of Revenues Over Expenses Before Capital Grants	3,581,647	7,173,825
Capital Grants	21,275	8,860
Increase in Net Assets	3,602,922	7,182,685
Net Assets, Beginning of Year	124,437,858	117,255,173
Net Assets, End of Year	$ 128,040,780	$ 124,437,858

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Floyd Memorial Foundation, Inc.
Statement of Activities
Year Ended December 31, 2009

Unrestricted Revenues		
Contributions	$	31,556
Golf outing		259,391
Investment return		609,862
Planned giving		2,373
Net assets released from restrictions		254,827
Total unrestricted revenues		1,158,009
Expenses		
Grants		283,445
Fundraising - golf outing		99,796
Fundraising - other		600
General and administrative		42,348
Total expenses		426,189
Change in Unrestricted Net Assets		731,820
Temporarily Restricted Net Assets		
Contributions		73,302
Net assets released from restrictions		(254,827)
Change in Temporarily Restricted Net Assets		(181,525)
Change in Net Assets	$	550,295
Unrestricted Net Assets		
Beginning of the year	$	2,951,874
Change in net assets		731,820
End of year	$	3,683,694
Temporarily Restricted Net Assets		
Beginning of the year	$	476,534
Change in net assets		(181,525)
End of year	$	295,009
Permanently Restricted Net Assets		
Beginning of year	$	11,170
End of year	$	11,170

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Statements of Cash Flows
Years Ended December 31, 2010 and 2009

	2010	2009
Operating Activities		
Receipts from and on behalf of patients	$ 202,604,982	$ 182,100,904
Payments to suppliers and contractors	(87,083,635)	(76,134,875)
Payments to employees	(100,352,752)	(90,524,935)
Other receipts, net	2,853,863	2,909,713
Net cash provided by operating activities	18,022,458	18,350,807
Noncapital Financing Activities		
Noncapital grants and contributions	392,997	546,479
Net cash provided by noncapital financing activities	392,997	546,479
Capital and Related Financing Activities		
Capital grants and contributions	21,275	8,860
Interest payments on long-term obligations	(3,931,627)	(3,860,393)
Principal paid on long-term debt and capital leases	(49,531,604)	(2,329,541)
Purchase of capital assets	(9,792,610)	(6,570,787)
Payment of bond issuance costs	(821,911)	-
Proceeds from issuance of long-term debt	55,908,100	-
Net cash used in capital and related financing activities	(8,148,377)	(12,751,861)
Investing Activities		
Proceeds from disposition of investments	11,445,662	34,280,677
Purchase of investments	(43,721,313)	(34,787,675)
Interest and dividends on investments	940,047	1,268,660
Investment in equity investees	-	120,686
Swap termination payment	(5,207,112)	-
Proceeds from sale of assets	26,571	-
Net cash provided by (used in) investing activities	(36,516,145)	882,348
Increase (Decrease) in Cash and Cash Equivalents	(26,249,067)	7,027,773
Cash and Cash Equivalents, Beginning of Year	49,049,956	42,022,183
Cash and Cash Equivalents, End of Year	$ 22,800,889	$ 49,049,956

	2010	2009
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by Operating Activities		
Operating income	$ 5,447,870	$ 6,371,481
Depreciation and amortization	11,607,832	12,328,768
Provision for uncollectible accounts	22,741,489	22,489,376
Loss on disposition of assets	50,632	267,047
Changes in operating assets and liabilities		
Patient accounts receivable	(27,772,183)	(24,994,380)
Estimated amounts due to third-party payers	1,365,199	1,143,916
Accounts payable and accrued expenses	5,605,369	1,112,612
Prepaid assets, supplies and other assets	(1,023,750)	(368,013)
Net cash provided by operating activities	$ 18,022,458	$ 18,350,807
Supplemental Cash Flows Information		
Property, plant and equipment additions in accounts payable	$ 832,212	$ 531,729
Deferred loss on defeasance of bonds	$ 6,802,507	$ -
Change in fair value of interest rate swap agreements	$ (1,381,684)	$ 11,047,461

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

Nature of Operations and Reporting Entity

Floyd Memorial Hospital and Health Services (Hospital) is an acute care hospital located in New Albany, Indiana. The Hospital is a component unit of Floyd County (County) and the Board of County Commissioners appoints members to the board of trustees of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Floyd County area.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally federal and state grants and county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific (such as county appropriations), investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued on or after November 30, 1989, and do not conflict with or contradict GASB pronouncements.

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2010 and 2009, cash equivalents consisted primarily of money market accounts.

Risk Management

The Hospital 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 and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than employee health claims. Settled claims have not exceeded this commercial coverage in any of the two preceding years.

The Hospital is self insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self insured portion of employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and Investment Income

Investments generally include U.S. Treasury, agency and instrumentality obligations with various maturities at time of acquisition and money market accounts and mutual funds. The investments in equity investees are reported on the equity method of accounting. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income includes dividend and interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

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

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	2 - 25 years
Buildings and leasehold improvements	5 - 40 years
Equipment	2 - 20 years

The Hospital capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. There was no interest capitalized and incurred at December 31, 2010 and 2009, respectively.

Other Assets

Split-dollar Life Insurance Policies. Other assets include the cumulative paid premiums under a split-dollar life insurance policy for certain employees of the Hospital. In accordance with the policy agreement, the Hospital will receive the greater of the cash surrender value of the policy or cumulative premiums upon termination of the contract by the employees upon their death.

Investment in Joint Ventures. The investment in joint ventures is accounted for by the equity method of accounting and is further described in Note 5.

Deferred Financing Costs. Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

Deferred Amounts on Refunding

Deferred amounts on refunding, which are included in long-term debt on the balance sheets, represent losses incurred in connection with the refunding of various long-term debt. Such losses are being amortized over the shorter of the term of the respective original debt or the term of the new debt using the straight-line method.

Other Long-term Liabilities

Other long-term liabilities consist of a deferred compensation agreement with a former employee. The agreement is to be funded with proceeds from operations. No additional benefits are being accrued under the agreement.

Interest Rate Swap Agreements

The Hospital uses interest rate swap agreements to manage financial risks related to interest rate movements and the effects on its cash flows. The Hospital is accounting for the interest rate swap agreements as hedging instruments. As a result, the agreements are recorded at their fair values in the balance sheets. The net cash payments or receipts under the interest rate swap agreements are recorded as an increase or decrease to interest expense.

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense for sick leave benefits is recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date, plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date. The estimated compensated absences liability expected to be paid more than one year after the balance sheet date is included in other long-term liabilities.

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 outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

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

Income Taxes

As an essential government function of the county, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

Floyd Memorial Foundation, Inc.

Floyd Memorial Foundation, Inc. (Foundation) is a legally separate, tax-exempt entity, established as an Indiana nonprofit corporation. The Foundation's primary function is to raise and hold funds to support the Hospital and programs in connection with the Hospital. The board of the Foundation is self perpetuating. The Foundation's articles of incorporation and bylaws do not irrevocably restrict any future changes in the purposes or memberships' provisions of the governing charter.

Although the Hospital does not control the timing or amount of receipts from the Foundation, the majority of the Foundation's resources and related income are for the benefit of the Hospital.

In accordance with GASB 39, *Determining Whether Certain Organizations Are Component Units- and amendment of GASB 14,* the Hospital's management has re-evaluated its assessment of the significance of the Foundation's financial statements as compared to the Hospital's financial statements. Accordingly, the Foundation's financial statements are not presented as of and for the year ended December 31, 2010.

During the year ended December 31, 2009, the Foundation provided $243,550 of support to the Hospital. Complete financial statements of the Foundation may be obtained from its administrative office at the following address: 1850 State Street, New Albany, Indiana.

The Foundation is a private nonprofit organization that reports under the FASB Accounting Standards Codification (ASC). As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation's statements in the Hospital's financial reporting entity for these differences.

Reclassifications

Certain 2009 financial statement amounts have been reclassified to conform with the 2010 financial statement presentation. Such reclassifications had no effect on the change in net assets.

Note 2: Net Patient Service Revenue

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

Medicare. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Medicaid. Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed at a prospectively determined rate per discharge for inpatient services and per visit for outpatient services.

The Hospital qualifies as a Medicaid Disproportionate Share Hospital (DSH) provider under Indiana Law (HEA 1095, Public Law 27-1992) and, as such, is eligible to receive supplemental Medicaid payments. The amounts of these additional supplemental payments are dependent on regulatory approval by agencies of the federal and state governments and is determined by level, extent and cost of uncompensated care (as defined) and various other factors. Supplemental payments have been made by the state of Indiana and the Hospital records such amounts as revenue when reasonably determined that the funds will be received. The Hospital recognized approximately $5,250,000 and $4,850,000 of net patient service revenue related to the supplemental payment program for the years ended December 31, 2010 and 2009, respectively. The Hospital recognized receivables from this program in the amount of $523,032 and $538,962 at December 31, 2010 and 2009, respectively, for various Indiana state fiscal years, which ends June 30 each year. It is reasonably possible estimates associated with the supplemental payment program could change materially in the near term.

Approximately 52% and 54% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2010 and 2009, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Note 3: Deposits, Investments and Investment Income

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposit may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of state law.

Deposits with financial institutions in the state of Indiana at year-end were entirely insured by the Federal Deposit Insurance Corporation (FDIC) or by the Indiana Public Deposit Insurance Fund (IPDIF). This includes any deposit accounts issued or offered by a qualifying financial institution. Accordingly, all deposits in excess of FDIC levels are covered by the IPDIF and considered collateralized.

Investments

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury, U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest to a limited extent in corporate bonds and equity securities.

At December 31, the Hospital had the following investments and maturities:

2010

		Maturities in Years			
Type	**Fair Value**	**Less Than 1**	**1 to 5**	**6 to 10**	**More Than 10**
Corporate bonds and securities	$ 7,426,170	$ -	$ 7,426,170	$ -	$ -
Money market mutual funds	11,267,047	11,267,047	-	-	-
U.S. agencies	15,530,914	-	12,569,318	-	2,961,596
Mutual funds	39,342,017	39,342,017	-	-	-
	$ 73,566,148	$ 50,609,064	$ 19,995,488	$ -	$ 2,961,596

2009

Type	Fair Value	Maturities in Years Less Than 1	1 to 5	6 to 10	More Than 10
U.S Treasury securities	$ 2,538,898	$ 2,538,898	$ -	$ -	$ -
Money market mutual funds	349,055	349,055	-	-	-
Mutual funds	37,441,779	37,441,779	-	-	-
	$ 40,329,732	$ 40,329,732	$ -	$ -	$ -

Interest Rate Risk – Interest rate risk is the risk of fair value losses arising from rising interest rates. The Hospital does not have a formal policy to limit its interest rate risk. The money market mutual funds are presented as an investment with a maturity of less than one year because they are redeemable in full immediately.

Credit Risk – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in corporate bonds to the top two ratings issued by nationally recognized statistical rating organizations (NRSROs). At December 31, 2010 and 2009, the Hospital's investments in U.S. agencies obligations not directly guaranteed by the U.S. Government were rated Aaa by Moody's Investor Services.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. At December 31, 2010 and 2009, the Hospital held no investments in repurchase agreements.

Concentration of Credit Risk – The Hospital places no limit on the amount that may be invested in any one issuer. At December 31, 2010, the Hospital had $7,426,170 invested in corporate bonds. At December 31, 2009, the Hospital held no investments in corporate bonds.

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets at December 31 as follows:

	2010	2009
Carrying value		
Deposits	$ 22,800,889	$ 49,049,956
Investments	73,566,148	40,329,732
	$ 96,367,037	$ 89,379,688

Included in the following balance sheet captions:

	2010	2009
Cash and cash equivalents	$ 22,800,889	$ 49,049,956
Restricted investments - current	1,821,978	1,076,230
Noncurrent cash and investments	71,744,170	39,253,502
	$ 96,367,037	$ 89,379,688

Investment Income

Investment income for the years ended December 31 consisted of:

	2010	2009
Interest and dividend income	$ 940,047	$ 1,268,660
Net increase in fair value of investments	960,765	3,124,054
	$ 1,900,812	$ 4,392,714

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31 consisted of:

	2010	2009
Medicare	$ 11,273,118	$ 9,577,213
Medicaid	1,551,719	1,063,765
Other third-party payers	14,912,683	10,728,670
Patients	13,936,718	15,521,276
	41,674,238	36,890,924
Less allowance for uncollectible accounts	14,788,614	15,035,994
	$ 26,885,624	$ 21,854,930

Note 5: Investments in Uncombined Entities

The investments in uncombined entities are accounted for on the equity method. The equity earnings of the uncombined entities are accounted for on the equity method and are in included in nonoperating revenues. Investments in uncombined entities consist of a 33.33% interest in Southern Indiana Rehabilitation Hospital (an acute rehabilitation hospital), a 48% interest in Kleinert, Kutz Associates Surgery Center, LLC (KKA), d/b/a Northgate Surgery Center, LLC (Joint Venture) (an outpatient surgery center), an 11% interest in Indiana Healthcare Reciprocal Risk Retention Group (Risk Retention Group) (a medical malpractice insurance captive), a 50% interest in Harrison-Floyd Health Services, LLC (an outpatient center providing urgent treatment services and occupational medicine) and a 50% interest in Northgate Medical Imaging, LLC, d/b/a Priority Imaging (an outpatient diagnostic imaging center).

Note 6: Capital Assets

Capital assets activity for the years ended December 31 were:

	2010				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 7,820,099	$ -	$ -	$ -	$ 7,820,099
Land improvements	3,514,191	8,238	-	-	3,522,429
Buildings and leasehold improvements	129,240,682	796,945	(176,203)	-	129,861,424
Equipment	114,525,129	9,171,545	(6,369,655)	-	117,327,019
Construction in progress	62,090	648,094			710,184
	255,162,191	10,624,822	(6,545,858)	-	259,241,155
Less accumulated depreciation					
Land improvements	2,681,946	102,882	-	-	2,784,828
Buildings and leasehold improvements	43,242,935	3,909,010	(166,639)	-	46,985,306
Equipment	85,603,643	7,494,355	(6,302,014)	-	86,795,984
Total accumulated depreciation	131,528,524	11,506,247	(6,468,653)	-	136,566,118
Capital assets, net	$ 123,633,667	$ (881,425)	$ (77,205)	$ -	$ 122,675,037

	2009				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 7,820,099	$ -	$ -	$ -	$ 7,820,099
Land improvements	3,513,814	33,827	(33,450)	-	3,514,191
Buildings and leasehold improvements	130,408,440	829,334	(2,008,678)	11,586	129,240,682
Equipment	116,524,904	6,166,426	(8,166,201)	-	114,525,129
Construction in progress	747	72,929	-	(11,586)	62,090
	258,268,004	7,102,516	(10,208,329)	-	255,162,191

	2009				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Less accumulated depreciation					
Land improvements	$ 2,615,043	$ 98,111	$ (31,208)	$ -	$ 2,681,946
Buildings and leasehold improvements	41,060,017	4,023,970	(1,841,052)	-	43,242,935
Equipment	85,560,088	8,112,577	(8,069,022)	-	85,603,643
Total accumulated depreciation	129,235,148	12,234,658	(9,941,282)	-	131,528,524
Capital assets, net	$ 129,032,856	$ (5,132,142)	$ (267,047)	$ -	$ 123,633,667

Note 7: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance from Risk Retention Group under a claims-made policy. The Hospital pays an annual premium to Risk Retention Group for its torts insurance coverage. The Risk Retention Group's governing agreement specifies that the Risk Retention Group will be self-sustaining through member premiums and will re-insure through commercial carriers for claims in excess of stop-loss amounts. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no liabilities were recorded at December 31, 2010 and 2009. It is possible this estimate could change materially in the near term.

Note 8: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self insured for health claims of participating employees and dependents up to an annual aggregate amount of $125,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is possible the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during the years ended December 31 is summarized as follows:

	2010	2009
Balance, beginning of year	$ 793,746	$ 810,963
Current year claims incurred and changes in estimates for claims incurred in prior years	8,483,856	5,485,880
Claims and expenses paid	(8,231,587)	(5,503,097)
Balance, end of year	$ 1,046,015	$ 793,746

Note 9: Long-term Obligations

The following is a summary of long-term debt transactions for the Hospital for the years ended December 31:

	2010				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds					
Series 1998	$ 14,570,000	$ -	$ 14,570,000	$ -	$ -
Series 2003	33,700,000	-	33,700,000	-	-
Series 2008	49,145,000	-	810,000	48,335,000	825,000
Series 2010	-	56,570,000	-	56,570,000	1,555,000
Capital lease obligations	583,190	-	451,604	131,586	131,586
	97,998,190	56,570,000	49,531,604	105,036,586	2,511,586
Less					
Unamortized bond discount	197,103	661,900	215,618	643,385	-
Deferred amount on refunding	2,817,176	8,021,574	1,375,529	9,463,221	-
Total long-term debt obligations	$ 94,983,911	$ 47,886,526	$ 47,940,457	$ 94,929,980	$ 2,511,586

	2009				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds					
Series 1998	$ 15,345,000	$ -	$ 775,000	$ 14,570,000	$ 810,000
Series 2003	34,175,000	-	475,000	33,700,000	475,000
Series 2008	49,800,000	-	655,000	49,145,000	810,000
Capital lease obligations	1,007,731	-	424,541	583,190	451,604
	100,327,731	-	2,329,541	97,998,190	2,546,604
Less					
Unamortized bond discount	213,358	-	16,255	197,103	-
Deferred amount on refunding	2,974,157	-	156,981	2,817,176	-
Total long-term debt obligations	$ 97,140,216	$ -	$ 2,156,305	$ 94,983,911	$ 2,546,604

The following is a summary of other long-term obligations for the Hospital for the years ended December 31:

	2010				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Accrued pension liabilities	$ 10,530,000	$ 2,181,718	$ 500,000	$ 12,211,718	$ -
Fair value of interest rate swap agreements	9,428,762	-	3,325,580	6,103,182	-
Other long-term liabilities	305,634	186,186	104,814	387,006	-
Total other long-term obligations	$ 20,264,396	$ 2,367,904	$ 3,930,394	$ 18,701,906	$ -

	2009				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Accrued pension liabilities	$ 9,133,883	$ 3,896,117	$ 2,500,000	$ 10,530,000	$ -
Fair value of interest rate swap agreements	20,476,224	-	11,047,462	9,428,762	-
Other long-term liabilities	669,339	-	363,705	305,634	104,814
Total other long-term obligations	$ 30,279,446	$ 3,896,117	$ 13,911,167	$ 20,264,396	$ 104,814

Revenue Bonds Payable

The Hospital has revenue bonds payable with the Indiana Healthcare Facility Financing Authority (Authority). The Master Trust Indenture requires certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service in the balance sheets. The Master Trust Indenture also places limits on the incurrence of additional borrowings and requires that certain measures of financial performance be maintained so long as the bonds are outstanding. At December 31, 2010, the Hospital was in compliance with such requirements.

Series 1998

In March 1998, the Hospital participated in the issuance of $21,150,000 Indiana Health Facility Financing Authority Hospital Revenue Refunding Bonds, Series 1998 Bonds (1998 Bonds), which bear interest at rates ranging from 4.5% to 5.4%. The proceeds were used for the advanced refunding of the Authority's Series 1992 Bonds. The 1998 Bonds were subject to retirement in varying principal amounts through 2022. The bonds were secured by the gross revenues of the Hospital and the assets restricted under the bond indenture agreement.

In April 2010, the Hospital defeased the remaining balance of the 1998 Bonds with proceeds from the issuance of the 2010 Bonds.

Series 2003

In December 2003, the Hospital participated in the issuance of $72,925,000 Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 2003A (2003A Bonds) and 2003B (2003B Bonds). The 2003A Bonds and 2003B Bonds, which were issued as auction rate securities, bore interest at the auction rate, as determined by the results of an auction every 35 days under an agreement with The Bank of New York. The proceeds were used for the advance refunding of the Authority's Series 1997 and Series 2000 Bonds and to finance certain capital projects. The 2003B Bonds were subject to retirement in varying principal payments through

2034. The bonds were secured by the gross revenues of the Hospital. Payments of bond principal were also secured by an insurance policy issued by a commercial insurer. Under the terms of the bond indentures, if for any reason the 2003B Bonds did not remarket on any given remarketing date, the interest rate defaulted to a maximum rate as calculated under the trust indentures, which was 150% of the AA rated commercial paper rate. In 2009, the bonds first failed to remarket on January 27, 2009, and there were no successful remarketings in 2009.

In December 2008, the Hospital defeased the remaining balance of the 2003A Bonds with proceeds from the issuance of the 2008 Bonds. However, the swap agreement associated with the 2003A Bonds was not terminated as part of the defeasance (Note 11).

In April 2010, the Hospital defeased the remaining balance of the 2003B Bonds with proceeds from the issuance of the 2010 Bonds. The swap agreement associated with the 2003 B Bonds was terminated as part of the defeasance (Note 11).

Series 2008

In December 2008, the Hospital participated in the issuance of $49,800,000 Indiana Health and Educational Facility Financing Authority Adjustable Rate Hospital Revenue Bonds, Series 2008 (2008 Bonds). The 2008 Bonds were issued as variable rate demand bonds under an agreement with Piper Jaffray & Co. The interest rate is reset daily and was .33% at December 31, 2010. The proceeds were used to refinance the Series 2003A and Series 2006 Bonds. The 2008 Bonds are subject to retirement in varying principal payments through 2036. The bonds are secured by the gross revenues of the Hospital. Payments of bond principal and interest are also secured by a letter of credit in the amount of $50,373,042 expiring on December 5, 2013, issued by a financial institution. In the event of a tender advance on the letter of credit, repayment terms consist of interest-only payments of the first 367 days with payment of principal and interest thereafter based on an amortization period extending through 24 months or the stated expiration of the agreement.

Series 2010

In April 2010, the Hospital participated in the issuance of $56,570,000 Indiana Health Facility Financing Authority Hospital Refunding Revenue Bonds, Series 2010 Bonds (2010 Bonds), which bear interest at rates ranging from 3.000% to 5.375%. The proceeds were primarily used for the advanced refunding of the 1998 and 2003B Bonds. The 2010 Bonds are subject to retirement in varying principal amounts through 2034. The bonds are secured by the gross revenues of the Hospital and the assets restricted under the bond indenture agreement.

Capital Lease Obligations

The Hospital is obligated under leases for certain medical equipment that are accounted for as capital leases. The lease agreements bear interest at various amounts up to 8.78%. Assets under capital leases, net of accumulated depreciation of $1,854,533 and $1,416,189 at December 31, 2010 and 2009, respectively, totaled $168,594 and $606,938 at December 31, 2010 and 2009, respectively.

The debt service requirements for long-term obligations as of December 31, 2010, were as follows:

Years Ending December 31	Total to be Paid	Principal	Interest
2011	$ 5,384,352	$ 2,511,586	$ 2,872,766
2012	5,400,092	2,520,000	2,880,092
2013	5,458,356	2,650,000	2,808,356
2014	5,458,342	2,740,000	2,718,342
2015	5,486,122	2,865,000	2,621,122
2016-2020	27,914,351	16,440,000	11,474,351
2021-2025	28,988,687	20,545,000	8,443,687
2026-2030	30,886,557	25,585,000	5,301,557
2031-2036	30,512,189	29,180,000	1,332,189
	$ 145,489,048	$ 105,036,586	$ 40,452,462

Note 10: Line of Credit

The Hospital has an unsecured open-ended demand line of credit in the amount of $10,000,000 with a bank. At the Hospital's option, amounts outstanding under the line of credit bear interest at the 30-day London Interbank Offering Rate (LIBOR), plus 1.25% adjusted monthly. There were no borrowings on the line of credit at December 31, 2010 and 2009.

Note 11: Interest Rate Swap Agreements

Objective of the Interest Rate Swap Agreements

The Hospital's asset/liability strategy is to have a mixture of fixed- and variable-rate debt to take advantage of market fluctuations. As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations and to lower its borrowing costs when compared against fixed-rate debt at the time of issuance, the Hospital entered into interest rate swap agreements in connection with its 2003A Bonds and 2003B Bonds. The original intention of the swap agreements is to effectively change the Hospital's variable interest rate on the 2003A Bonds and 2003B Bonds to a synthetic fixed rate of 4.05%.

The 2003A Bonds were defeased in December 2008 and related swap agreement was re-designated to a portion of the 2008 Bonds. The 2003B Bonds were defeased in April 2010 and the related swap agreement was terminated at the time of the issuance of the 2010 Bonds.

Terms

The 2003B swap agreement provided for the Hospital to receive interest from the counterparty at 70% of the one-month LIBOR and to pay interest to the counterparty at a fixed rate of 4.05%. The notional amount of the 2003B swap agreement was $33,700,000 on December 31, 2009. This swap was terminated in April 2010.

The 2003A swap agreement was entered into on November 10, 2003, and is scheduled to expire on March 1, 2034, and required no initial net cash receipt or payment by the Hospital. The agreement provides for the Hospital to receive interest from the counterparty at 70.00% of the one-month LIBOR and to pay interest to the counterparty at a fixed rate of 4.05% on notional amounts of $33,225,000 and $33,725,000 at December 31, 2010 and 2009, respectively. Beginning in 2009, the notional amount of the swap agreement declines by a corresponding amount each time a principal payment was originally scheduled to become due on the associated debt until the notional amount reaches $2,650,000 at the termination of the swap agreement. Under the swap agreement, the Hospital pays or receives the net interest amount monthly, with the monthly settlements included in interest expense.

Fair Value

As of December 31, 2010 and 2009, the swap agreements had a fair value of $(6,103,182) and $(9,428,762), respectively, calculated using the par-value method, *i.e.*, the fixed rate on the swap agreements were compared with the current fixed rates that could be achieved in the marketplace should the swap agreements be unwound. The fixed-rate components were valued by discounting the fixed-rate cash flows using the current yield to maturity of a comparable bond. The variable-rate components were assumed to be at par value because the interest rates reset to the market rate at every reset date. The fair values were then calculated by subtracting the estimated market value of the fixed components from the established market value of the variable components. The fair value of the swap agreements are recognized in long-term liabilities in the Hospital's balance sheets. As the swap agreements are effective hedging instruments, the offsetting balances are reflected as a deferred outflow of resources on the Hospital's balance sheets. The changes in fair value of the swap agreements of $(1,881,531) and $11,047,462 for the years ended December 31, 2010 and 2009, respectively, are shown as adjustments to the carrying amounts of the related deferred outflow of resources on the balance sheets.

Credit Risk

The swap agreement's fair value represented the Hospital's credit exposure to the counterparty as of December 31, 2010. Should the counterparty to this transaction fail to perform according to the terms of the swap agreement, the Hospital has a maximum possible loss equivalent to the swap agreement's fair value at that date. As of December 31, 2010, the Hospital was not exposed to credit risk because the swap agreement had a negative fair value. The swap agreement counterparty was rated A by Fitch Ratings and Standard & Poor's and A2 by Moody's Investors Service as of December 31, 2010 and 2009. To mitigate the potential for credit risk, if the counterparty's credit quality rating falls below the current rating for at least two of the three rating agencies, the fair value of the swap agreement is to be fully collateralized by the counterparty with U. S. Treasury obligations to be held by a third-party custodian on behalf of the Hospital. The Hospital does not currently have a policy of requiring the counterparty post collateral in the event the Hospital becomes exposed to credit risk. The Hospital does not currently have a policy requiring a master netting agreement with the counterparty and does not currently have such an agreement in place.

Basis Risk

The interest rate swap agreements expose the Hospital to basis risk should the relationship between LIBOR and the auction rate set by the Hospital's remarketing agent change in a manner adverse to the Hospital. If an adverse change occurs in the relationship between these rates, the expected cost savings may not be realized.

Termination Risk

The Hospital or the counterparty may terminate the interest rate swap agreements if the other party fails to perform under the terms of the contract. If the interest rate swap agreements are terminated, the variable-rate bonds would no longer have a synthetic fixed rate of interest. Also, if the interest rate swap agreements have negative fair values at the time of termination, the Hospital would be liable to the counterparty for a payment equal to the interest rate swap agreements' fair value.

Swap Payments and Associated Debt

Using rates as of December 31, 2010, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term are set forth in the table below. As rates vary, variable-rate interest payments and net swap payments will vary.

Years Ending December 31	2008 Bonds Principal	2008 Bonds Interest	Hedging Derivative Instrument, Net	Total to be Paid
2011	$ 825,000	$ 157,238	$ 1,287,656	$ 2,269,894
2012	860,000	154,419	1,265,058	2,279,477
2013	920,000	151,416	1,242,127	2,313,543
2014	930,000	148,353	1,218,366	2,296,719
2015	970,000	145,174	1,193,607	2,308,781
2016-2020	5,495,000	673,361	5,549,628	11,717,989
2021-2025	9,155,000	557,239	4,424,404	14,136,643
2026-2030	12,870,000	364,225	2,480,107	15,714,332
2031-2035	14,160,000	131,840	363,884	14,655,724
2036-2040	2,150,000	1,186	-	2,151,186
	$ 48,335,000	$ 2,484,451	$ 19,024,837	$ 69,844,288

Note 12: Billing Under Arrangement

As noted in Note 5, the Hospital has a 48% interest in KKA, d/b/a Joint Venture which has been accounted for on the equity method. As part of the Joint Venture, the Hospital has entered into a billing under arrangement agreement, in which nongovernmental program patient revenues are billed under the Hospital's employer identification number (EIN) and 95% of patient revenue is remitted to the Joint Venture as a management fee, inclusive of all operating expenses and costs associated with the services being rendered. For the year ended December 31, 2010 and 2009, net patient service revenue related to the Joint Venture was $3,897,638 and $4,215,799, respectively, and associated management fee expense was $3,900,605 and $4,191,616, respectively. At December 31, 2010 and 2009, net patient accounts receivable related to the Joint Venture was $479,182 and $483,763, respectively, and accounts payable to the counterparty of the Joint Venture, KKA, was $458,016 and $459,490, respectively.

Note 13: Operating Leases

The Hospital has entered into various operating leases for office space and medical equipment expiring at various years through 2020. Rent expense was $2,495,399 and $2,051,812 for the years ended December 31, 2010 and 2009, respectively.

Future minimum lease payments at December 31, 2010, are:

2011	$ 2,379,285
2012	2,185,767
2013	2,012,618
2014	1,935,272
2015	1,854,168
2016-2020	8,515,225
Future minimum lease payments	$ 18,882,335

Note 14: Defined Benefit Pension Plan

Plan Description

The Hospital's defined benefit pension plan is a single-employer defined benefit pension plan administered by the plan's board of trustees who are appointed by the County Commissioners of Floyd County, Indiana. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The authority to establish and amend benefit provisions is set forth in Indiana Code 16-22-3-11. The plan issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing to the investment manager at Renaissance Investment Management, Inc., 1700 Young Street, Cincinnati, OH 45210-1521 or by calling 513.723.4500.

Effective May 1, 2010, the plan was amended to freeze the traditional benefit formula and modify the benefit formula for employees employed or re-employed on or after May 1, 2010. These benefits will now accrue under an account based formula.

Funding Policy

The authority to establish and amend obligations of plan members is established by the written agreement between the Hospital's board of trustees and the plan administrator. Plan members are required to contribute 0% of their annual covered salary. The Hospital is required to contribute at an actuarially determined rate. The Hospital's annual required contributions for 2010 and 2009, were $3,035,799 and $4,820,000, respectively, and contributions made to the plan for 2010 and 2009, were $500,000 and $2,500,000, respectively.

Annual Pension Cost and Net Pension Obligation

The Hospital's annual pension cost and net pension obligation to the plan for December 31 were as follows:

	2010	2009
Annual required contribution	$ 3,035,799	$ 4,820,000
Interest on net pension obligation	769,739	663,000
Adjustment to annual required contribution	(1,623,820)	(1,586,883)
Annual pension cost	2,181,718	3,896,117
Contributions made	(500,000)	(2,500,000)
Increase in net pension obligation	1,681,718	1,396,117
Net pension obligation at beginning of the year	10,530,000	9,133,883
Net pension obligation at end of the year	$ 12,211,718	$ 10,530,000

Funded Status and Funding Progress

As of May 1, 2010, the most recent actuarial valuation date, the plan was 78.3% funded. The actuarial accrued liability for benefits was $39,667,607 and the actuarial value of assets was $31,053,250 resulting in an unfunded actuarial accrued liability (UAAL) of $8,614,357. The covered payroll (annual payroll of active employees covered by the plan) was $58,966,439 and the ratio of the UAAL to the covered payroll was 14.6%.

As of December 31, 2010, the fair value of the pension trust fund assets had decreased to $30,780,298.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the health care cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

The annual required contribution for 2010 was determined as part of an actuarial valuation on May 1, 2010, using the projected unit credit actuarial cost method. The actuarial assumptions included (a) 7.5% investment rate of return (net of administrative expenses) and (b) projected salary increases per year. The actuarial value of assets was determined using market value. The UAAL is being amortized on a level dollar basis over a 10-year period.

Three-year Trend Information

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2008	$ 2,795,462	0%	$ 9,133,883
December 31, 2009	$ 3,896,117	64%	$ 10,530,000
December 31, 2010	$ 2,181,718	23%	$ 12,211,718

Note 15: Defined Contribution Pension Plan

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by a board of trustees appointed by the County Commissioners of Floyd County, Indiana. The plan provides retirement benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Contributions made by plan members at December 31, 2010 and 2009, were $3,726,814 and $3,247,194, or 5% and 4%, respectively, of total payroll. Contributions made by the Hospital at December 31, 2010 and 2009, were $995,248 and $865,016, or 1%, respectively, of total payroll for both years.

Note 16: Disclosures About Fair Value of Financial Instruments

The following methods were used to estimate the fair value of financial instruments.

The fair values of certain of these instruments were calculated by discounting expected cash flows, which method involves significant judgments by management and uncertainties. Fair value is the estimated amount at which financial assets or liabilities could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Because no market exists for certain of these financial instruments and because management does not intend to sell these financial instruments, the Hospital does not know whether the fair values shown below represent values at which the respective financial instruments could be sold individually or in the aggregate.

Investments

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Long-term Debt

Fair value is estimated based on the borrowing rates currently available to the Hospital for debt with similar terms and maturities.

Interest Rate Swap Agreements

The fair value has been estimated by a third party.

The following table presents estimated fair values of the Hospital's financial instruments at December 31:

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 22,800,889	$ 22,800,889	$ 49,049,956	$ 49,049,956
Investments	73,566,148	73,566,148	40,329,732	40,329,732
	$ 96,367,037	$ 96,367,037	$ 89,379,688	$ 89,379,688
Financial liabilities				
Long-term debt	$ 104,393,201	$ 103,475,683	$ 97,801,087	$ 97,887,719
Interest rate swap agreements	6,103,182	6,103,182	9,428,762	9,428,762
	$ 110,496,383	$ 109,578,865	$ 107,229,849	$ 107,316,481

Note 17: Significant Estimates and Concentrations

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

Allowance for Net Patient Service Revenue Adjustments

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

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Notes 1 and 7.

Incurred, But Not Reported, Employee Health Insurance Claims

Estimates of incurred, but not reported, health insurance claims are described in Note 8.

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Guarantee

The Hospital guarantees certain third-party debt and capital leases of unconsolidated affiliated organizations.

The debt guarantee expires on April 15, 2011. At December 31, 2010 and 2009, the Hospital has guaranteed 33% of the $3,150,000 and $3,750,000, respectively, outstanding debt of an affiliated organization.

The capital lease guarantee terms are through the duration of the capital leases, which expire through 2012. At December 31, 2010 and 2009, the Hospital has guaranteed 50% of the $1,427,653 and $2,476,451, respectively, outstanding capital leases of an affiliated organization.

Current Economic Conditions

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

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

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

Note 18: Floyd Memorial Foundation, Inc.

Financial Statements

The financial statements of the Foundation are presented in accordance with the provisions of the FASB ASC. The FASB ASC requires the Foundation to distinguish between contributions that increase permanently restricted net assets, temporarily restricted net assets and unrestricted net assets. It also requires recognition of contributions, including contributed services meeting certain criteria, at fair values. The FASB ASC establishes standards for external financial statements of nonprofit organizations and requires a statement of financial position, statement of activities and statement of cash flows. As permitted by GASB Statement No. 34, the Hospital has elected not to present a statement of cash flows for the Foundation in the basic financial statements of the Hospital's reporting entity.

Investments and Investment Return

Investments at December 31, 2009, consisted of the following:

Cash and cash equivalents	$ 91,211
Corporate bonds	237,058
Bond mutual funds	103,900
Asset-backed securities	89,644
U.S. Government securities	521,011
Common stocks	1,092,936
Equity mutual funds	1,347,191
	$ 3,482,951

Total investment return at December 31, 2009, is comprised of the following:

Dividends and interest income	$ 87,489
Realized gains (losses) on investments	(331,612)
Change in fair value of investments	853,985
	$ 609,862

Note 19: Changes in Accounting Principle

In 2010, the Hospital adopted GASB 53, *Accounting and Financial Reporting for Derivative Instruments*, and changed its method of accounting for its interest rate swap agreements. The effect of this change had the following impact on the December 31, 2009, financial statement presentation:

	As Originally Reported	As Adjusted	Effect of Change
Balance Sheet			
Deferred outflow of resources - interest rate swap agreements	$ -	$ 9,428,762	$ 9,428,762
Total assets	$ 249,796,106	$ 259,224,868	$ 9,428,762
Net assets - unrestricted	$ 83,687,549	$ 93,116,311	$ 9,428,762
Total net assets	$ 115,009,096	$ 124,437,858	$ 9,428,762
Total liabilities and net assets	$ 249,796,106	$ 259,224,868	$ 9,428,762
Statement of Revenues, Expenses and Changes in Net Assets			
Interest rate swap gain (loss)	$ 11,047,462	$ -	$ (11,047,462)
Total nonoperating revenues (expenses)	$ 11,849,806	$ 802,344	$ (11,047,462)
Excess of revenues over expenses before capital grants	$ 18,221,287	$ 7,173,825	$ (11,047,462)
Increase in net assets	$ 18,230,147	$ 7,182,685	$ (11,047,462)
Net assets, beginning of year	$ 96,778,949	$ 117,255,173	$ 20,476,224
Net assets, end of year	$ 115,009,096	$ 124,437,858	$ 9,428,762

Supplementary Information

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Schedule of Funding Progress
December 31, 2010 and 2009

Required Supplementary Information

Schedule of funding progress for defined employee pension plan consisted of the following:

(Dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets a	Actuarial Accrued Liability (AAL) - Entry Age b	Unfunded AAL (UAAL) b-a	Funded Ratio a/b	Covered Payroll c	UAAL as a Percentage of Covered Payroll (b-a)/c
December 31, 2008	$ 36,280	$ 42,570	$ 6,290	85%	$ 52,001	12%
December 31, 2009	$ 27,655	$ 45,316	$ 17,661	61%	$ 53,293	33%
December 31, 2010	$ 31,053	$ 39,668	$ 8,615	78%	$ 58,966	15%