



KING'S DAUGHTERS'
Hospital & Health Services

A family of caring.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

**TABLE OF CONTENTS
DECEMBER 31, 2010 AND 2009**

	Page
Report of Independent Auditors	1
Consolidated Financial Statements	
Consolidated Balance Sheets	2
Consolidated Statements of Operations	4
Consolidated Statements of Changes in Net Assets	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	8



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REPORT OF INDEPENDENT AUDITORS

Board of Managers
The King's Daughters' Hospital and Health
Services and Affiliated Organization
Madison, Indiana

We have audited the accompanying consolidated balance sheets of The King's Daughters' Hospital and Health Services and Affiliated Organization (the "Hospital"), as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

Blue & Co., LLC

April 7, 2011

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2010 AND 2009

ASSETS	2010	2009
Current assets		
Cash and cash equivalents	\$ 8,773,039	\$ 11,619,830
Investments - short term	-0-	9,108,548
Patient accounts receivable, net of estimated uncollectibles of \$6,018,680 in 2010 and \$5,211,809 in 2009	11,212,808	11,745,113
Inventories	1,970,608	1,889,855
Prepaid expenses and other current assets	1,014,438	1,074,678
Other assets - current portion	287,519	234,278
Current portion of assets whose use is limited	-0-	1,207,963
Total current assets	23,258,412	36,880,265
Assets whose use is limited, net of amount required to meet current obligations	152,056,023	49,392,001
Property and equipment		
Land	5,442,334	5,420,989
Buildings and improvements	42,708,291	42,513,515
Fixtures and equipment	39,259,583	37,109,543
	87,410,208	85,044,047
Less accumulated depreciation	54,959,170	50,636,550
	32,451,038	34,407,497
Construction in progress	10,036,485	2,647,658
Property and equipment, net	42,487,523	37,055,155
Other assets, net of current portion	4,125,848	3,065,934
Investments - long term	1,000,000	1,000,000
Total assets	\$ 222,927,806	\$ 127,393,355

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2010 AND 2009

LIABILITIES AND NET ASSETS

	2010	2009
Current liabilities		
Accounts payable	\$ 1,487,374	\$ 1,235,864
Accrued payroll and payroll withholdings	1,056,813	831,458
Accrued expenses	6,086,890	5,954,657
Estimated third-party payor settlements	300,000	1,100,000
Current portion of obligations under capital leases	615,639	479,174
Current portion of long-term debt	-0-	955,000
Total current liabilities	9,546,716	10,556,153
Long-term liabilities		
Obligations under capital leases, net of current portion	493,098	849,459
Long-term debt, net of current portion	97,853,607	11,095,000
Deferred compensation liabilities	851,683	730,435
Total long-term liabilities	99,198,388	12,674,894
Total liabilities	108,745,104	23,231,047
Net assets		
Controlling interest net assets		
Unrestricted	114,032,135	103,989,784
Temporarily restricted	127,154	117,555
Permanently restricted	10,000	10,000
Total controlling interest net assets	114,169,289	104,117,339
Noncontrolling interest	13,413	44,969
Total net assets	114,182,702	104,162,308
Total liabilities and net assets	\$ 222,927,806	\$ 127,393,355

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
Changes in unrestricted net assets		
Operating revenues		
Net patient service revenue	\$ 111,975,580	\$ 112,523,063
Other revenue	536,908	635,924
Net assets released from restrictions	52,787	45,929
Total operating revenues	112,565,275	113,204,916
Operating expenses		
Salaries and wages	49,187,752	48,111,013
Employee benefits and payroll taxes	12,463,469	12,628,882
Professional medical fees	853,642	867,054
Medical supplies	4,374,337	4,345,131
Other supplies	1,208,101	1,247,895
Drugs	6,298,600	6,129,218
Purchased services	6,153,849	4,514,007
Utilities	1,513,352	1,553,776
Insurance	1,301,390	1,422,493
Depreciation and amortization	4,982,410	5,669,231
Interest	601,187	787,934
Provision for bad debts	13,575,949	13,470,446
Other operating expenses	4,940,265	5,602,139
Total operating expenses	107,454,303	106,349,219
Income from operations	5,110,972	6,855,697
(Income) loss from operations attributable to noncontrolling interest	(36,024)	(65,598)
Income from operations attributable to controlling interest	5,074,948	6,790,099
Nonoperating revenues	5,034,983	9,013,444
Excess revenues	10,109,931	15,803,543
Members' distributions	(67,580)	(41,000)
Change in unrestricted net assets	10,042,351	15,762,543
Changes in temporarily restricted net assets		
Contributions	62,386	84,150
Net assets released from restrictions	(52,787)	(45,929)
Change in temporarily restricted net assets	9,599	38,221
Total change in controlling interest net assets	10,051,950	15,800,764
Total change in noncontrolling interest net assets	36,024	65,598
Total change in net assets	\$ 10,087,974	\$ 15,866,362

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
Unrestricted Net Assets		
Beginning of year	\$ 103,989,784	\$ 88,227,241
Change in unrestricted net assets	10,042,351	15,762,543
End of year	\$ 114,032,135	\$103,989,784
Temporarily Restricted Net Assets		
Beginning of year	\$ 117,555	\$ 79,334
Change in temporarily restricted net assets	9,599	38,221
End of year	\$ 127,154	\$ 117,555
Permanently Restricted Net Assets		
Beginning of year	\$ 10,000	\$ 10,000
Contributions	-0-	-0-
End of year	\$ 10,000	\$ 10,000
Noncontrolling Interest		
Beginning of year	\$ 44,969	\$ 20,371
Distributions to noncontrolling interest member	(67,580)	(41,000)
Excess revenues attributable to noncontrolling interest	36,024	65,598
End of year	\$ 13,413	\$ 44,969

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2010 AND 2009**

	2010	2009
Cash flows from operating activities		
Total change in net assets	\$ 10,087,974	\$ 15,866,362
Adjustments to reconcile total change in net assets to net cash from operating activities		
Depreciation	4,934,235	5,084,503
Amortization	48,175	584,728
Provision for bad debts	13,575,949	13,470,446
Loss on write-off of bond costs on retired bonds	790,218	-0-
Loss on disposal of capital assets	7,514	225
Change in net realized and unrealized gains and losses on investments	(4,436,347)	(8,023,797)
Changes in operating assets and liabilities		
Patient accounts receivable	(13,043,644)	(10,391,712)
Other receivables		
Inventories	(80,753)	(106,896)
Prepaid expenses and other current assets	60,240	97,474
Accounts payable	(232,012)	341,205
Accrued payroll and payroll withholdings	225,355	(1,723,753)
Accrued expenses	132,233	96,871
Estimated third-party payor settlements	(800,000)	250,000
Net cash from operating activities	11,269,137	15,545,656
Cash flows from investing activities		
Purchases of property and equipment	(9,556,848)	(2,818,370)
Proceeds from sale of capital assets	9,400	83,806
Change in investments	9,108,548	(10,108,548)
Change in assets whose use is limited	(97,019,712)	(999,251)
Change in other assets	(99,736)	130,160
Change in deferred compensation liabilities	121,248	258,355
Net cash from investing activities	(97,437,100)	(13,453,848)
Cash flows from financing activities		
Principal payments on obligations under capital leases	(563,043)	(419,750)
Principal payments on long-term debt	(12,050,000)	(905,000)
Payment on bond issuance costs	(1,851,812)	-0-
Change in bond discount	(2,181,393)	-0-
Borrowings on long-term debt	100,035,000	-0-
Distributions to minority interest holders	(67,580)	(41,000)
Net cash from financing activities	83,321,172	(1,365,750)
Net change in cash and cash equivalents	(2,846,791)	726,058
Cash and cash equivalents, beginning of year	11,619,830	10,893,772
Cash and cash equivalents, end of year	\$ 8,773,039	\$ 11,619,830

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	\$ <u>607,249</u>	\$ <u>779,030</u>
Supplemental disclosure of noncash operating and investing activities		
Property and equipment acquired under accounts payable	\$ <u>483,522</u>	\$ <u>309,652</u>
Supplemental disclosure of noncash investing and financing activities		
Property and equipment acquired under capital leases	\$ <u>343,147</u>	\$ <u>182,885</u>

See accompanying notes to consolidated financial statements.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

1. NATURE OF OPERATIONS

The King's Daughters' Hospital and Health Services ("KDHS") is a not-for-profit, acute care hospital owned by the Bethany Circle of King's Daughters' of Madison, Indiana, Inc., located in Madison, Indiana. KDHS is organized for the purpose of providing healthcare services to the residents of Jefferson County and the surrounding area. KDHS's primary sources of support are from patient revenues. Patient revenues include funds received from Medicare, state agencies, insurance companies, and the patients themselves.

Madison Catheterization Services, LLC ("MCS"), is a limited liability company owned 51 percent by KDHS. MCS performs catheterization services for the residents of Jefferson County, Indiana and surrounding areas. MCS's primary source of support is from patient revenues.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by KDHS and MCS (collectively the "Hospital") in the preparation of the consolidated financial statements are summarized below:

Reporting Entity and Consolidation Policy

The accompanying consolidated financial statements include the accounts of KDHS and MCS. Intercompany transactions and balances have been eliminated in consolidation.

Management's Estimates

Management uses estimates and assumptions in preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if any, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less excluding amounts included in assets whose use is limited.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Investments

Investments include certificates of deposit amounts maturing within one year of the dates of the consolidated balance sheets and shares of preferred stock in a local bank, with a term of five years and carrying a dividend rate of 7.25 percent. Investments are recorded at cost, which approximates market value.

Patient Accounts Receivable and Net Patient Service Revenue

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

Allowances for Patient Uncollectible Accounts

The Hospital estimates an allowance for uncollectible patient accounts receivable based on an evaluation of the aging of the accounts, historical losses, current economic conditions, and other factors unique to their service area and the healthcare industry.

Inventories

Inventories consist of medical supplies, pharmaceuticals, and office supplies and are valued at the lower-of-cost or market, with cost being determined on the first-in, first-out (FIFO) method.

Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the Hospital's Board of Managers for future capital improvements and other long-term uses, over which the Board retains control and may at its discretion subsequently use for other purposes; assets held by trustees under indenture agreements; temporarily restricted assets whose use by the Hospital has been limited by donors to a specific time period or purpose; permanently restricted net assets whose use by the Hospital has been restricted by donors in perpetuity; and deferred compensation assets related to certain deferred compensation agreements.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair market value in the consolidated balance sheets. Investment income or loss, including unrealized gains and losses on trading securities,

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

interest, and dividends is included in nonoperating gains of unrestricted net assets, unless the income is restricted by donor or law.

Property and Equipment

Property and equipment are recorded at cost, except for donations, which are recorded at the fair market value at the date of the donation.

Property and equipment include expenditures for additions and repairs which substantially increase the useful lives of existing property and equipment. Maintenance, repairs, and minor improvements are expensed as incurred.

The property and equipment of the Hospital are being depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association's *Estimated Useful Lives of Depreciable Hospital Assets*.

Cost of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets, if any, are capitalized as a component of the cost of acquiring those assets. For the years ended December 31, 2010 and 2009, interest costs incurred were as follows:

	<u>2010</u>	<u>2009</u>
Interest costs capitalized	\$ 851,069	\$ -0-
Interest costs expensed	<u>601,187</u>	<u>787,934</u>
Interest costs incurred	<u>\$ 1,452,256</u>	<u>\$ 787,934</u>

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity.

Consolidated Statements of Operations

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as operating revenues and expenses and included within the line *income from operations* in the Consolidated Statements of Operations. Peripheral and incidental transactions are reported as nonoperating revenues. Nonoperating revenues which are excluded from *income from operations* include contributions and donations, investment income, and gain or loss on disposal of capital assets.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Performance Indicator

The Consolidated Statements of Operations include *excess revenues*. Consistent with industry practice, changes in unrestricted net assets which are excluded from *excess revenues* include, if any, unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets.)

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are reported as deductions from revenue.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give, if any, are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted revenue if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

Income Taxes

KDHHS is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code.

MCS is a limited liability company which is treated as a partnership for income tax purposes. As such, net taxable income or loss is taxed directly to the members and not to MCS. Accordingly, income taxes have not been reflected in the accompanying consolidated financial statements.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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 and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The Hospital is insured for medical malpractice claims and judgments.

Accounting For Non-Controlling Interest

In 2010, new accounting guidance relative to the presentation of non-controlling interests in not-for-profit organizations' financial statements became effective. The Hospital adopted this guidance and reclassified the noncontrolling interest as a component of net assets in the accompanying consolidated balance sheets and statements of changes in net assets. The reclassification did not impact total net assets or the total change in net assets.

Reclassifications

Certain 2009 amounts have been reclassified to provide for consistency with reporting of 2010 information. These reclassifications have no effect on the previously reported total change in net assets or net assets.

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the 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 April 7, 2011.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

3. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. Assets whose use is limited are reported at market value and include the following at December 31, 2010 and 2009:

	2010	%	2009	%
Cash and cash equivalents	\$ 20,431,488	13.4 %	\$ 4,101,988	8.1 %
Common stock and options	29,487,515	19.4	27,892,434	55.1
Equity mutual funds	701,970	0.5	739,118	1.5
Bond mutual funds	10,071,516	6.6	10,589,632	20.9
Asset-backed securities	1,202,491	0.8	1,801,301	3.6
International bonds	49,083	0.0	45,038	0.1
Corporate bonds	898,912	0.6	662,306	1.3
U.S. Government securities	89,213,048	58.7	4,768,147	9.4
	<u>152,056,023</u>	<u>100.0 %</u>	<u>50,599,964</u>	<u>100.0 %</u>
Less amount required for current obligations	<u>-0-</u>		<u>1,207,963</u>	
Assets whose use is limited, net of amount required to meet current obligations	<u>\$ 152,056,023</u>		<u>\$ 49,392,001</u>	
	2010	%	2009	%
Board-Designated Funds	\$ 48,304,898	31.8 %	\$ 47,449,292	93.8 %
Trustee-Held Funds	102,762,288	67.6	2,292,682	4.5
Donor-Restricted Funds	137,154	0.1	127,555	0.3
Deferred Compensation	851,683	0.5	730,435	1.4
	<u>\$ 152,056,023</u>	<u>100.0 %</u>	<u>\$ 50,599,964</u>	<u>100.0 %</u>

Investment income is comprised of the following for the years ended December 31, 2010 and 2009:

	2010	2009
Dividends and interest income	\$ 1,718,531	\$ 1,379,517
Realized gains (losses) on investments	1,006,095	(2,289,676)
Change in net unrealized gains and losses on investments	3,430,252	10,313,473
Investment fees	<u>(271,595)</u>	<u>(355,129)</u>
Total investment income, net	<u>\$ 5,883,283</u>	<u>\$ 9,048,185</u>

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Board-Designated Funds

The Hospital's Board of Managers approved the funding of depreciation expense to meet the capital asset replacement needs of the facility. Depreciation is funded totally with expenditures for capital assets reducing the funded depreciation balance. All income earned by the Board-designated funds is left to accumulate as additions to the funds.

Trustee-Held Funds

The trustee-held funds are restricted for the payments of principal, interest, and construction costs related to certain long-term debt agreements.

Donor-Restricted Funds

Donor-restricted funds represent contributions that have been restricted by the donors for a specific purpose.

Deferred Compensation Funds

The deferred compensation funds represent assets that have accumulated under separate deferred compensation plans. The Hospital simply maintains the funds for the participants until they are withdrawn according to the specific terms of each separate deferred compensation agreement. The Hospital records liabilities equal to the deferred compensation assets.

Fair Value Measurements and Disclosures

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.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009**

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 are as follows:

	Level 1	Level 2	Level 3	Total
Assets whose use is limited				
Common stock and options	\$ 29,487,515	\$ -0-	\$ -0-	\$ 29,487,515
Equity mutual funds	701,970	-0-	-0-	701,970
Bond mutual funds	10,071,516	-0-	-0-	10,071,516
Asset-backed securities	-0-	1,202,491	-0-	1,202,491
International bonds	-0-	49,083	-0-	49,083
Corporate bonds	-0-	898,912	-0-	898,912
U.S. Government securities	-0-	89,213,048	-0-	89,213,048
	<u>\$ 40,261,001</u>	<u>\$ 91,363,534</u>	<u>\$ -0-</u>	<u>\$ 131,624,535</u>

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

	Level 1	Level 2	Level 3	Total
Assets whose use is limited				
Common stock and options	\$ 27,892,434	\$ -0-	\$ -0-	\$ 27,892,434
Equity mutual funds	739,118	-0-	-0-	739,118
Bond mutual funds	10,589,632	-0-	-0-	10,589,632
Asset-backed securities	-0-	1,801,301	-0-	1,801,301
International bonds	-0-	45,038	-0-	45,038
Corporate bonds	-0-	662,306	-0-	662,306
U.S. Government securities	-0-	4,768,147	-0-	4,768,147
	<u>\$ 39,221,184</u>	<u>\$ 7,276,792</u>	<u>\$ -0-</u>	<u>\$ 46,497,976</u>

The following table sets forth a summary of changes in the fair values of the Hospital's level 3 assets for the year ended December 31, 2009:

	<u>Cash Surrender Value of Life Insurance</u>
Balance, beginning of year	\$ 726,877
Change in cash surrender value of life insurance	-0-
Transfers out of assets whose use is limited	<u>(726,877)</u>
Balance, end of year	<u>\$ -0-</u>

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

4. OTHER ASSETS

Other assets consist of the following at December 31, 2010 and 2009:

	2010	2009
Bond issue costs	\$1,851,812	\$1,422,358
Bond issue costs, accumulated amortization	(8,671)	(592,636)
Goodwill of physician practices	8,060,000	8,060,000
Goodwill of physician practices, accumulated amortization	(6,705,933)	(6,705,933)
Investment in captive insurance company	335,311	335,311
Notes receivable	880,848	781,112
Total other assets	4,413,367	3,300,212
Less: current portion of other assets	(287,519)	(234,278)
Other assets, net of current portion	\$4,125,848	\$3,065,934

Bond issue costs are being amortized over the 35-year life of the bonds beginning in 2010.

Goodwill relates to the purchase of physician practices in 1997 and 2000. Goodwill is tested each year to determine whether there is any impairment.

The Hospital is an 11 percent owner of Indiana Healthcare Reciprocal Risk Retention Group, a risk retention company created to purchase professional liability and general liability insurance for its members. The Hospital accounts for this investment using the cost method.

Physician recruiting notes receivable are forgiven if the physicians meet the period of service requirement. If the physicians do not meet the period-of-service requirement, the notes are immediately due in full. Other physician notes receivable are paid back over the terms of the notes. All physician notes receivable are in varying amounts maturing through July 2017 and carry interest rates ranging from 0 percent to 9.25 percent.

The current portion of other assets represents the amount of notes receivable from physicians expected to be repaid or forgiven in the next fiscal year, according to individual employment contracts.

During 2010, the Hospital repaid the remaining outstanding balance of the 1997 Revenue Bonds. As a result of this repayment, the Hospital incurred a loss of \$790,218 due mostly to the remaining unamortized portion of bond issue costs associated with the 1997 Revenue Bonds. This loss is reported in Nonoperating revenues on the Consolidated Statements of Operations.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

5. OBLIGATIONS UNDER CAPITAL LEASES

The Hospital is the lessee of certain equipment under capital leases expiring in various years through 2015. The assets and liabilities under capital leases are initially recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. Amortization of assets held under capital leases is included in depreciation expense and was \$500,277 and \$419,568 for the years ended December 31, 2010 and 2009, respectively.

Following is a summary of property held under capital leases:

	2010	2009
Equipment	\$2,591,140	\$2,247,993
Less: accumulated amortization	1,506,902	1,006,625
	\$1,084,238	\$1,241,368

Minimum future lease payments under capital leases as of December 31, 2010 are as follows:

Year Ending December 31,	Amount
2011	\$ 668,561
2012	484,168
2013	26,723
2014	11,223
2015	6,512
	1,197,187
Less: amount representing interest	88,450
Present value of minimum lease payments	\$1,108,737

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

6. LONG-TERM DEBT

At December 31, 2010 and 2009, the Hospital was obligated for long-term debt agreements as follows:

	2010	2009
Indiana Health Facility Financing Authority Note, dated July 1997, payable in semi-annual principal installments commencing February 1998 through August 2027, in amounts ranging from \$205,000 to \$575,000. Serial remaining fixed interest rates ranging from 5.10% to 5.625%. Secured by gross revenues.	\$ -0-	\$12,050,000
Indiana Finance Authority Hospital Revenue Bonds, dated October 2010, payable in annual principal installments commencing August 2015 through August 2045, in amounts ranging from \$1,370,000 to \$6,400,000. Serial remaining fixed interest rates ranging from 4.5% to 5.5%. Secured by gross revenues.	<u>100,035,000</u>	<u>-0-</u>
Total long-term debt	100,035,000	12,050,000
Less unamortized bond discounts	(2,181,393)	-0-
Less current portion	<u>-0-</u>	<u>(955,000)</u>
Long-term debt, net of current portion	<u>\$ 97,853,607</u>	<u>\$11,095,000</u>

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

Maturities of long-term debt for each of the five years subsequent to December 31, 2010, are as follows:

<u>Year Ending December 31,</u>	<u>Principal Amount</u>
2011	\$ -0-
2012	-0-
2013	-0-
2014	-0-
2015	1,370,000
Thereafter	98,665,000
Unamortized bond discounts	<u>(2,181,393)</u>
Total	<u>\$ 97,853,607</u>

Under the terms of the Series 2010 Bonds, the Hospital is required to maintain certain deposits with a trustee. Such deposits are reported in the consolidated financial statements as assets whose use is limited. These agreements also place limits on the occurrence of additional borrowings and require that the Hospital satisfy certain covenants, including debt service coverage ratio, days cash on hand, and submission of audited financial statements.

7. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are donor-restricted for a specific use or by the passage of time. Permanently restricted net assets are donor-restricted assets whereby the principal amount is never to be expended. Income earned from these principal amounts includes both temporarily restricted and unrestricted amounts. Temporarily and permanently restricted net assets include the following at December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Temporarily restricted		
Prenatal/Postnatal Education Program Fund	\$ 2,012	\$ 2,214
Tobacco Settlement Fund	108,843	99,840
Teen Event Fund	6,751	6,751
Girls on the Run Fund	4,926	4,142
May Library Fund	<u>4,622</u>	<u>4,608</u>
Total temporarily restricted net assets	<u>\$ 127,154</u>	<u>\$ 117,555</u>
Permanently restricted		
Heberhart Endowment	<u>\$ 10,000</u>	<u>\$ 10,000</u>

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

8. ENDOWMENT

The Hospital's endowment consists of one individual donor-restricted fund established by the donor to function as an endowment. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds, including funds designated by the Board of Managers to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Managers has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets, if any, is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds.

- (1) The duration and preservation of the fund
- (2) The purposes of the Hospital and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Hospital
- (7) The investment policies of the Hospital

The Hospital has adopted investment and spending policies for endowment assets that attempt to balance the mission of building capital for future use with the corresponding obligation to support current and future needs of the Hospital. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period. Under this policy, as approved by the Board of Managers, the endowment assets are invested in a manner that is intended to produce long-term growth of capital without undue exposure to risk.

To satisfy its long-term rate of return objectives, the Hospital relies on a total return strategy in which investment decisions shall be made with the intent of maximizing the long-term total return of the portfolio through market value changes (realized and unrealized) and through earned income (dividends and interest).

On balances of endowed funds, as of the beginning of each fiscal year, an amount as determined by the Hospital Board will be distributed for the intended purposes of the

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009**

endowment annually. Growth of the endowment will come from the annual earnings of investments in excess of distributions plus contributions made to the endowment.

Endowment Net Asset Composition by Type of Fund as of December 31, 2010:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	<u>\$ -0-</u>	<u>\$ 10,000</u>	<u>\$ 10,000</u>

Changes in Endowment Net Assets for the Year Ended December 31, 2010:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ -0-	\$ 10,000	\$ 10,000
Contributions	-0-	-0-	-0-
Investment income	-0-	-0-	-0-
Appropriation of endowment assets for expenditure	-0-	-0-	-0-
Endowment net assets, end of year	<u>\$ -0-</u>	<u>\$ 10,000</u>	<u>\$ 10,000</u>

Endowment Net Asset Composition by Type of Fund as of December 31, 2009:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	<u>\$ -0-</u>	<u>\$ 10,000</u>	<u>\$ 10,000</u>

Changes in Endowment Net Assets for the Year Ended December 31, 2009:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ -0-	\$ 10,000	\$ 10,000
Contributions	-0-	-0-	-0-
Investment income	-0-	-0-	-0-
Appropriation of endowment assets for expenditure	-0-	-0-	-0-
Endowment net assets, end of year	<u>\$ -0-</u>	<u>\$ 10,000</u>	<u>\$ 10,000</u>

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

	2010	2009
Permanently restricted net assets		
The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or UPMIFA	\$ 10,000	\$ 10,000

9. NET PATIENT SERVICE REVENUE

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

- **Medicare.** The Hospital is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Hospital is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicare 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 Hospital'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. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. As of December 31, 2010, the Hospital's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2006.
- **Medicaid.** The Hospital is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Hospital is reimbursed for Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) 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. There is no cost settlement for either of the inpatient or outpatient programs.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

The Hospital has also entered into preferred provider agreements with certain commercial insurance carriers. Payment arrangements to the Hospital under these agreements include discounted charges and fee schedule payments.

10. CHARITY CARE

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies provided under its charity care policy. The following information measures the level of charity care provided during the years ended December 31, 2010 and 2009.

	<u>2010</u>	<u>2009</u>
Charges forgone, based on established rates	<u>\$3,373,317</u>	<u>\$3,905,315</u>

11. PENSION PLAN

The Hospital sponsors a defined contribution pension plan that covers all eligible employees who work over 1,000 hours a year. Physicians are eligible for enrollment immediately after their hire date. Prior to February 1, 2010, all other employees must have completed one year of employment and be 21 years of age. Beginning February 1, 2010, all employees are eligible for enrollment on the first day of the month following their hire date. The Hospital contributes 4 percent for each eligible employee. The employee may contribute up to 15 percent with a maximum of 6 percent being matched at a rate of 50 percent. For the years ended December 31, 2010 and 2009, the amount of pension expense was \$2,951,337 and \$2,830,846, respectively.

12. DEFERRED COMPENSATION AGREEMENTS

Previously, the Hospital maintained an informal deferred compensation plan whereby amounts were withdrawn from participating physicians' pay and held by the Hospital until such time that the participating physicians retired. The Hospital no longer offers this plan, but still records a liability for any amounts which were unpaid at year-end. The deferred compensation asset and liability amounts under this agreement were both \$149,539 and \$175,527 at December 31, 2010 and 2009, respectively.

The Hospital funds an executive deferred compensation plan. The plan accumulates cash value over time. The Hospital records an asset and liability amount equal to the market value of the deferred compensation plan. The deferred compensation asset and liability amounts under this agreement were both \$596,141 and \$459,373 at December 31, 2010 and 2009, respectively.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

Previously, the Hospital maintained a deferred compensation plan for a select group of key management employees. Under the terms of the plan, the Hospital contributed 4 percent of a participant's compensation, as defined in the agreement, each calendar quarter. The Hospital no longer offers this plan, but still records a liability for any amounts that were unpaid at year-end. The deferred compensation asset and liability amounts under this agreement were both \$106,003 and \$95,535 at December 31, 2010 and 2009, respectively.

13. PROFESSIONAL LIABILITY INSURANCE

The Indiana Medical Malpractice Act, IC 34-18, provides a maximum recovery of \$250,000 for an occurrence of malpractice and \$1,250,000 for an injury or death of a patient due to an act of malpractice. The Act requires physicians to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$750,000 in the annual aggregate and hospitals to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$5,000,000 for hospitals with less than 100 occupied beds. The Hospital's insurance policies conform to the Indiana Malpractice Act. The Act also requires the Hospital to pay a surcharge to the State Patient's Compensation Fund. This fund may be used to pay medical malpractice claims in excess of the annual aggregate amount noted above, under certain terms and conditions.

The Hospital maintains professional liability insurance through a multiprovider reciprocal risk retention group (the "Group"), in which premiums are accrued based on the Group's experience to date. This provides protection from liability in amounts not to exceed as follows:

	2010	2009
Hospital per occurrence	\$ <u>250,000</u>	\$ <u>250,000</u>
Hospital aggregate	\$ <u>5,000,000</u>	\$ <u>5,000,000</u>
Group umbrella aggregate	\$ 10,000,000	\$ 10,000,000
Group first additional umbrella aggregate	10,000,000	10,000,000
Group second additional umbrella aggregate	<u>10,000,000</u>	<u>10,000,000</u>
Total Group umbrella aggregate	\$ <u>30,000,000</u>	\$ <u>30,000,000</u>

Liabilities for incurred but not reported losses at December 31, 2010 and 2009 are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Hospital's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the policies not be renewed or

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Hospital intends to continue carrying such insurance.

14. OPERATING LEASES

The Hospital leases certain equipment under noncancelable operating leases expiring in various years through 2014. Minimum future rental payments under these noncancelable operating leases as of December 31, 2010, are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2011	\$ 222,779
2012	78,361
2013	39,578
2014	<u>22,355</u>
Total minimum lease payments	<u>\$ 363,073</u>

The Hospital incurred \$463,502 and \$379,865 in total rent expense for the years ended December 31, 2010 and 2009, respectively, under both cancelable and noncancelable leases.

15. CONCENTRATIONS OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements. The mix of gross revenues and receivables from patients and third-party payors at December 31, 2010 and 2009, was as follows:

	<u>2010</u>		<u>2009</u>	
	<u>Revenue</u>	<u>Receivables</u>	<u>Revenue</u>	<u>Receivables</u>
Medicare	46 %	35 %	45 %	32 %
Medicaid	13	11	13	12
Blue Cross	14	10	14	8
Other Commercial	21	21	22	19
Self-Pay	<u>6</u>	<u>23</u>	<u>6</u>	<u>29</u>
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

The Hospital maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Hospital has not experienced any losses on such accounts. The Hospital believes it is not exposed to any significant credit risk on cash.

16. FUNCTIONAL EXPENSES

The Hospital provides general healthcare services to residents within its geographic area. Expenses related to providing these services are broken down as follows for the years ended December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Healthcare services	\$ 96,206,158	\$ 95,160,145
General and administrative	<u>11,248,145</u>	<u>11,189,074</u>
	<u>\$107,454,303</u>	<u>\$ 106,349,219</u>

17. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Cash and Cash Equivalents

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates its fair value.

Assets Whose Use is Limited

These assets are reported in the consolidated balance sheets at fair value. The fair value amounts are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Accounts Payable, Accrued Payroll and Payroll Withholdings, and Accrued Expenses

The carrying amounts reported in the consolidated balance sheets for accounts payable, accrued payroll and payroll withholdings, and accrued expenses approximate their fair value.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

Estimated Third-Party Payor Settlements

The carrying amount reported in the consolidated balance sheets for estimated third-party payor settlements approximates its fair value.

Long-Term Debt, Obligations Under Capital Leases and Deferred Compensation Liabilities

The carrying amount and fair value reported in the consolidated balance sheets for the combined amounts of long-term debt and obligations under capital leases were \$98,962,344 and \$98,419,161, respectively, for 2010 and \$13,378,633 and \$14,130,116, respectively, for 2009. The carrying amount reported in the consolidated balance sheets for deferred compensation liabilities approximates its fair value.

18. CONTINGENCIES

There are a variety of legal proceedings and claims by others against the Hospital in a variety of matters arising out of the conduct of the Hospital's business. The ultimate resolution of such claims would not, in the opinion of management, have a material adverse effect on the consolidated financial statements.

19. COMMITMENTS

As of December 31, 2010, the Hospital has construction and renovation project commitments as follows:

<u>Project</u>	<u>Expected Date of Completion</u>	<u>Estimated Total Cost of Project</u>	<u>Costs Incurred as of December 31, 2010</u>
Hilltop MOB/Hospital	2013	\$ 100,000,000	\$ 5,938,384
Meditech EHR Migration	2012	10,000,000	3,953,995
All others	Various	310,000	<u>144,106</u>
			<u>\$ 10,036,485</u>