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July 3, 2008

Board of Directors  
Hendricks Regional Health  
P.O. Box 409  
Danville, Indiana 46122-0409

We have reviewed the audit report prepared by Blue & Company, LLC, Independent Public Accountants, for the period January 1, 2007 to December 31, 2007. 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 Hendricks Regional Health, as of December 31, 2007, and the results of its operations for the period then ended, on the basis of accounting described in the report.

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

STATE BOARD OF ACCOUNTS



**CONSOLIDATED FINANCIAL STATEMENTS**

**AND**

**SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2007 AND 2006**

# HENDRICKS REGIONAL HEALTH

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*blueandco.com*

## REPORT OF INDEPENDENT AUDITORS

Board of Trustees  
Hendricks Regional Health  
Danville, Indiana

We have audited the accompanying consolidated balance sheets of Hendricks Regional Health (Hospital) as of December 31, 2007 and 2006 and the related consolidated statements of revenues, expenses and 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 and the Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Hospital as of December 31, 2007 and 2006, and the consolidated results of its operations, changes in net assets and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Management's discussion and analysis on pages i through vi is not a required part of the basic consolidated financial statements but is supplementary information required by accounting principles generally accepted in the United States. 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.

Board of Trustees  
Hendricks Regional Health  
Danville, Indiana

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

*Blue & Co., LLC*

March 11, 2008

# HENDRICKS REGIONAL HEALTH

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

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This section of Hendricks Regional Health's (Hospital) annual consolidated financial statements presents background information and management's discussion and analysis (MD&A) of the Hospital's consolidated financial performance during the year ended December 31, 2007. This MD&A does include a discussion and analysis of the activities and results of the Blended Component Units, Hendricks Regional Health Foundation, Inc. and Hendricks Ambulatory Management Company. Please read it in conjunction with the Hospital's consolidated financial statements that follow this MD&A.

### **Financial Highlights**

- The Hospital's net assets increased approximately \$13,016,050 or 8.8% in 2007.
- The Hospital reported operating income of approximately \$11,255,000 for 2007, representing an increase of approximately \$1,762,000 in comparison to the year 2006 results.
- The Hospital continued its expansion of facilities and equipment in 2007 as net capital assets increased approximately \$6,414,000.

### **Using This Annual Report**

The Hospital's consolidated financial statements consist of three statements – a Balance Sheet; a Statement of Operations and Changes in Net Assets; and a Statement of Cash Flows. These consolidated financial statements and related notes provide information about the activities and the financial position of the Hospital.

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

All of the current year's revenue earned and expenses incurred are accounted for in the Consolidated Statement of Operations and Changes in Net Assets.

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

# HENDRICKS REGIONAL HEALTH

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

### The Hospital's Net Assets

Table 1: Assets, Liabilities, and Net Assets

	<u>2007</u>	<u>2006</u>	<u>Change</u>
<b>Assets</b>			
Current assets	\$ 36,053,924	\$ 29,617,634	\$ 6,436,290
Capital assets, net	142,537,083	136,123,075	6,414,008
Assets whose use is limited	53,031,780	50,735,374	2,296,406
Other assets	<u>1,200,537</u>	<u>1,152,456</u>	<u>48,081</u>
Total assets	<u>\$ 232,823,324</u>	<u>\$ 217,628,539</u>	<u>\$ 15,194,785</u>
<b>Liabilities</b>			
Current liabilities	\$ 17,344,688	\$ 14,433,255	\$ 2,911,433
Long-term debt	<u>53,220,135</u>	<u>54,584,856</u>	<u>(1,364,721)</u>
Total liabilities	70,564,823	69,018,111	1,546,712
<b>Minority interest</b>	632,023	-0-	632,023
<b>Net assets</b>			
Invested in capital assets, net of related debt	88,240,948	80,512,219	7,728,729
Unrestricted	<u>73,385,530</u>	<u>68,098,209</u>	<u>5,287,321</u>
Total net assets	<u>161,626,478</u>	<u>148,610,428</u>	<u>13,016,050</u>
Total liabilities and net assets	<u>\$ 232,823,324</u>	<u>\$ 217,628,539</u>	<u>\$ 15,194,785</u>

The significant changes in the Hospital's assets were Capital Assets increasing \$6,414,000 and Current Assets increasing \$6,436,000. Patient accounts receivable, a portion of current assets increased \$3,062,000.

The Hospital completed its construction of a third medical office building on the main campus. The new building was completed in the spring of 2007 and added 121,000 square feet. The cost of this project was approximately \$17,805,000.

Design work began in 2007 on a new surgical tower to be built on the main campus. The estimated cost of this project is \$60,000,000 with occupancy occurring in 2010. The Hospital is evaluating financing options which could include new debt issue, internal financing or some combination.

# HENDRICKS REGIONAL HEALTH

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

### Operating Results and Changes in the Hospital's Net Assets

Table 2: Operating Results and Changes in Net Assets

	2007	2006	Change
<b>Operating revenue</b>			
Net patient service revenue	\$ 148,461,516	\$ 133,831,372	\$ 14,630,144
Other operating revenue	3,312,900	2,998,746	314,154
Total operating revenue	<u>151,774,416</u>	<u>136,830,118</u>	<u>14,944,298</u>
<b>Operating expenses</b>			
Salaries and benefits	83,121,782	76,692,393	6,429,389
Medical supplies and drugs	14,617,548	14,419,970	197,578
Depreciation and amortization	11,241,781	10,312,256	929,525
Other operating expenses	31,538,410	25,912,284	5,626,126
Total operating expenses	<u>140,519,521</u>	<u>127,336,903</u>	<u>13,182,618</u>
Operating income	11,254,895	9,493,215	1,761,680
<b>Nonoperating income (expense), net</b>	1,849,178	665,790	1,183,388
<b>Minority interest</b>	<u>(88,023)</u>	<u>-0-</u>	<u>(88,023)</u>
Change in net assets	13,016,050	10,159,005	2,857,045
<b>Net assets, beginning of year</b>	<u>148,610,428</u>	<u>138,451,423</u>	<u>10,159,005</u>
<b>Net assets, end of year</b>	<u><u>\$ 161,626,478</u></u>	<u><u>\$ 148,610,428</u></u>	<u><u>\$ 13,016,050</u></u>

### Sources of Revenue

During 2007, the Hospital derived substantially all of its revenue from patient service and other related activities. A significant portion of the patient service revenue is from patients that are insured by government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. Revenues from the Medicare and Medicaid programs represented 42% of the Hospital's gross revenues in 2006 but only 24% of the Hospital's net patient service revenues.

# HENDRICKS REGIONAL HEALTH

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

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Following is a table of major sources of gross patient revenues for 2007:

<u>Payor</u>	<u>% of Gross Revenues</u>
Medicare	37.3%
Anthem/Blue Cross	24.2%
Self Pay	6.5%
Sagamore	5.6%
Medicaid	4.9%
United Health Care	4.6%
Cigna	2.9%
Aetna	2.5%
SHO/M-Plan	2.3%
Other	9.2%
Total	<u>100.0%</u>

The Hospital's patient mix between inpatient and outpatient services is different than other hospital averages. The Hospital's outpatient services represented 72% of the Hospital's gross patient revenue in 2007. According to the Indiana Hospital Association's IHA Databank, the State of Indiana's average outpatient percent of total charges was only 48% for 2007.

### **Operating and Financial Performance**

The Hospital performed well in 2007 with a return on equity of 8.1%, up from last year's 6.8%. The hospital's debt service coverage ratio remained strong at approximately 4.7 times.

This following section highlights the major financial factors for 2007:

- The Hospital's discharges for 2007 declined 9.1% to 5,829 from 2006's total of 6,411; the Hospital's adjusted patient days increased slightly to 84,971 in 2007 compared to 84,336 in 2006. The increase in adjusted patient days was due to the growth in outpatient revenues offsetting the decrease in inpatient utilization.
- During 2007 the Hospital's net patient services revenue was enhanced by Indiana Medicaid Municipal Hospital Payments totaling \$5,161,000 compared to Payments of \$2,334,000 received in 2006.

# HENDRICKS REGIONAL HEALTH

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

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- Operating expenses increased \$13,183,000, or 10.3%. This growth is attributable to the increasing costs of resources utilized to provide services to the Hospital's patients.
- Salaries and Benefits represented the largest increase over 2006. Salaries and Benefits expense for 2007 was \$6,429,000 greater than 2006. The increase represented an 8.3% change from 2006. The increase in Salaries and Benefits was necessary to provide quality care and to meet the expectations of our patients.

### Capital Assets

During 2007, the Hospital invested \$15 million in capital assets net of asset disposals. The change in capital assets is outlined in the following table:

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Land and improvements	\$ 13,567,580	\$ 12,986,095	\$ 581,485
Buildings and fixed equipment	153,530,804	135,935,606	17,595,198
Major moveable equipment	58,249,858	50,957,249	7,292,609
Construction in progress	<u>3,775,955</u>	<u>14,163,535</u>	<u>(10,387,580)</u>
Total capital assets	229,124,197	214,042,485	15,081,712
Less accumulated depreciation	<u>86,587,114</u>	<u>77,919,410</u>	<u>8,667,704</u>
Capital assets - net	<u>\$ 142,537,083</u>	<u>\$ 136,123,075</u>	<u>\$ 6,414,008</u>

As previously mentioned the Hospital continues to increase space and equipment resources to meet the needs of the community. The Hospital strives to replace equipment as it becomes obsolete as well as upgrade equipment as needed.

### Debt

During 2007 the Hospital issued new debt that was used to refund a major portion of the 2002 Indiana Bond Bank Special Hospital Program Bonds. The new 2007 bonds were issued through the Indiana Bond Bank. More detailed information about the Hospital's long-term debt is presented in the Notes to the Consolidated Financial Statements.

# HENDRICKS REGIONAL HEALTH

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

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## **Economic Outlook**

Management believes that the health care industry's and the Hospital's operating margins will continue to be under pressure because of changes in payor mix and growth in operating expenses that are in excess of the increases in contractually arranged and legally established payments received for services rendered. Another factor that poses a challenge to management is the increasing competitive market for the delivery of health care services. The ongoing challenge facing the Hospital is to continue to provide quality patient care in this competitive environment, and to attain reasonable rates for the services that are provided while managing costs. The most significant cost factor affecting the Hospital is the increases in labor costs due to the increasing competition for quality health care workers.

## **Contacting the Hospital's Financial Management**

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital Controller's Office, at PO Box 409, Danville, IN, 46122-0409.

# HENDRICKS REGIONAL HEALTH

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2007 AND 2006

### ASSETS

	2007	2006
<b>Current assets</b>		
Cash and cash equivalents	\$ 8,618,490	\$ 5,245,874
Investments	522,294	553,615
Patient accounts receivable, less allowance for uncollectible account of \$6,219,107 in 2007 and \$4,821,634 in 2006	23,911,031	21,065,532
Inventories	765,383	570,270
Other current assets	941,726	937,343
Current portion of assets whose use is limited	1,295,000	1,245,000
Total current assets	<u>36,053,924</u>	<u>29,617,634</u>
<b>Assets whose use is limited</b>		
Board designated funded depreciation investments	53,997,153	51,693,762
Other board designated investments	329,627	286,612
Total assets whose use is limited	<u>54,326,780</u>	<u>51,980,374</u>
Less current portion	1,295,000	1,245,000
Noncurrent assets whose use is limited	<u>53,031,780</u>	<u>50,735,374</u>
<b>Capital assets</b>		
Land	7,321,310	7,317,811
Depreciable capital assets	221,802,887	206,724,674
	<u>229,124,197</u>	<u>214,042,485</u>
Less accumulated depreciation	86,587,114	77,919,410
Capital assets, net	<u>142,537,083</u>	<u>136,123,075</u>
<b>Other assets</b>		
Bond issue costs, net of accumulated amortization of \$32,442 in 2007 and \$174,547 in 2006	933,514	901,829
Physician recruitment and other assets	267,023	250,627
Total other assets	<u>1,200,537</u>	<u>1,152,456</u>
Total assets	<u>\$ 232,823,324</u>	<u>\$ 217,628,539</u>

See accompanying notes to consolidated financial statements.

# HENDRICKS REGIONAL HEALTH

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2007 AND 2006

### LIABILITIES AND NET ASSETS

	<u>2007</u>	<u>2006</u>
<b>Current liabilities</b>		
Current portion of long-term debt	\$ 1,295,000	\$ 1,245,000
Accounts payable	4,083,784	2,926,534
Accrued salaries and related liabilities	6,785,187	5,580,705
Accrued expenses and other current liabilities	4,211,636	3,664,513
Accrued interest	669,081	716,503
Estimated third-party settlements	300,000	300,000
Total current liabilities	<u>17,344,688</u>	<u>14,433,255</u>
<b>Long-term liabilities</b>		
Long-term debt, net current portion	53,001,135	54,365,856
Physician recruitment liability	219,000	219,000
Total long-term liabilities	<u>53,220,135</u>	<u>54,584,856</u>
Total liabilities	70,564,823	69,018,111
<b>Minority interest</b>	632,023	-0-
<b>Net assets</b>		
Invested in capital assets, net of related debt	88,240,948	80,512,219
Unrestricted	73,385,530	68,098,209
Total net assets	<u>161,626,478</u>	<u>148,610,428</u>
Total liabilities and net assets	<u>\$ 232,823,324</u>	<u>\$ 217,628,539</u>

See accompanying notes to consolidated financial statements.

# HENDRICKS REGIONAL HEALTH

## CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
<b>Operating revenue</b>		
Net patient service revenue	\$ 148,461,516	\$ 133,831,372
Other operating revenue	3,312,900	2,998,746
Total operating revenue	151,774,416	136,830,118
<b>Operating expenses</b>		
Salaries and wages	65,300,746	59,772,677
Employee benefits	17,821,036	16,919,716
Professional medical fees	949,652	830,911
Other professional fees	7,451,571	3,945,675
Medical and surgical supplies	9,859,615	9,545,545
Drugs and intravenous solutions	4,757,933	4,874,425
Food	837,678	816,946
Purchased services	11,021,230	9,856,196
Equipment rental	2,294,322	1,749,836
Telephone and utilities	2,981,378	2,974,266
Depreciation and amortization	11,241,781	10,312,256
Insurance	1,250,398	1,033,344
Other supplies and expenses	4,752,181	4,705,110
Total operating expenses	140,519,521	127,336,903
Operating income	11,254,895	9,493,215
<b>Nonoperating income (expense)</b>		
Investment income	4,187,767	3,146,483
Interest expense	(2,338,589)	(2,480,693)
Total nonoperating income (expense), net	1,849,178	665,790
<b>Minority interest</b>	(88,023)	-0-
Change in net assets	13,016,050	10,159,005
<b>Net assets</b>		
Beginning of year	148,610,428	138,451,423
End of year	\$ 161,626,478	\$ 148,610,428

See accompanying notes to consolidated financial statements.

# HENDRICKS REGIONAL HEALTH

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

	2007	2006
<b>Operating activities</b>		
Cash received from patient services	\$ 145,616,017	\$ 131,781,598
Cash paid for salaries, wages and benefits	(81,922,724)	(75,875,479)
Cash paid to vendors and suppliers	(47,161,927)	(39,523,448)
Other receipts, net	3,312,900	2,998,746
Net cash flows from operating activities	19,844,266	19,381,417
<b>Capital and related financing activities</b>		
Acquisition and construction of capital assets	(16,684,013)	(21,962,349)
Gain on disposal of assets	-0-	1,146,358
Proceeds from disposal of capital assets	16,750	-0-
Interest on long-term debt	(2,338,589)	(2,480,693)
Proceeds from long-term debt	44,915,000	-0-
Payments for bond premium and issue costs	(5,003,529)	-0-
Principal payments for long-term debt	(48,355,000)	(1,200,000)
Net cash flows from capital and related financing activities	(27,449,381)	(24,496,684)
<b>Investing activities</b>		
Nonoperating gains, primarily investment income	4,187,767	3,146,483
Minority interest share of income	(88,023)	-0-
Other changes in investments and assets whose use is limited	5,308,653	686,661
Net cash flows from investing activities	9,408,397	3,833,144
Net change in cash and cash equivalents	1,803,282	(1,282,123)
<b>Cash and cash equivalents</b>		
Beginning of year	8,950,426	10,232,549
End of year	\$ 10,753,708	\$ 8,950,426
<b>Reconciliation of cash and cash equivalents to the balance sheets</b>		
Cash and cash equivalents		
In current assets	\$ 8,618,490	\$ 5,245,874
In board designated funds	2,135,218	3,704,552
Total cash and cash equivalents	\$ 10,753,708	\$ 8,950,426

See accompanying notes to consolidated financial statements.

# HENDRICKS REGIONAL HEALTH

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

	2007	2006
<b>Reconciliation of operating income to net cash flows from operating activities</b>		
Operating income	\$ 11,254,895	\$ 9,493,215
Adjustment to reconcile operating income to net cash flows from operating activities		
Depreciation and amortization	11,241,781	10,312,256
Bad debts	10,919,039	9,328,908
Changes in operating assets and liabilities		
Patient accounts receivable	(13,764,538)	(11,378,682)
Inventories	54,098	53,172
Other current assets	(4,383)	57,671
Other assets	(1,872,503)	693,960
Accounts payable	317,118	(459,816)
Accrued salaries and related liabilities	1,199,058	816,914
Accrued expenses and other current liabilities	547,123	475,819
Accrued interest	(47,422)	(12,000)
Net cash flows from operating activities	\$ 19,844,266	\$ 19,381,417
 <b>Supplemental disclosure of cash flows information</b>		
Cash paid for interest, net of interest capitalized of \$399,160 in 2007 and \$397,320 in 2006	\$ 2,386,011	\$ 2,492,693
 <b>Noncash capital and related financing activities</b>		
Property purchases in accounts payable	\$ 949,738	\$ 764,674

See accompanying notes to consolidated financial statements.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### 1. SIGNIFICANT ACCOUNTING POLICIES

#### Organization and Reporting Entity

Hendricks Regional Health (Hospital) is a county owned facility operating under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital provides inpatient, outpatient and emergency care. The Board of County Commissioners of Hendricks County appoints the Governing Board of the Hospital and a financial benefit/burden relationship exists between the County and the Hospital. For these reasons, the Hospital is considered a component unit of Hendricks County.

U.S. generally accepted accounting principles require the consolidated financial statements present the Hospital and its blended component units, collectively referred to as "primary government". The component units discussed below are included in the Hospital's reporting entity because of the significance of their operational or financial relationship with the Hospital. A blended component unit, although a legally separate entity, is in substance part of the primary government unit's of operations and exists solely to provide services to the Hospital.

#### Basis of Consolidation

The accompanying consolidated financial statements include the accounts of the Blended Component Unit - Hendricks Regional Health Foundation, Inc. (Foundation), a separate not-for-profit entity organized to support the operations of the Hospital. It also includes the accounts of the Blended Component Unit - Hendricks Ambulatory Management Company, LLC (HAMCO), a separate limited liability company entity. All significant transactions between the entities have been eliminated for financial reporting purposes.

#### Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### Enterprise Fund Accounting

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

### Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement Number 20, *Accounting and Financial Reporting For Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

### Cash and Cash Equivalents

Cash and cash equivalents include all cash held in checking, savings and money market accounts available for operating purposes with original maturity dates of 90 days or less. The Hospital maintains its cash in accounts, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on cash and cash equivalents.

### Investments

Investments consist mainly of certificates of deposit with original maturities of greater than 90 days and other non-cash equivalent securities. Investments are reported at fair value.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### Patient Accounts Receivable and Net Patient Service Revenue

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. The Hospital is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The Hospital is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG). The Hospital is reimbursed for Medicare and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the 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. These programs have audited the year-end cost report filed with the Medicare program through December 31, 2005 with differences reflected as deductions from revenue in 2007. Amounts for unresolved cost reports for 2006 through 2007 are reflected in estimated third-party settlements on the consolidated balance sheets. During 2007 and 2006, the Hospital recognized approximately \$51,000 and \$55,000 in income, respectively, due to the differences between original estimates and subsequent revisions for the final settlement of cost reports.

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

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

### Inventories

Pharmaceutical inventories are valued at the lower of cost or market with cost being determined on the first-in, first-out (FIFO) method while medical and all other supplies are priced using the last-in, first-out (LIFO) method. Inventories at year-end consist of the following:

	2007	2006
Medical supplies and other	\$ 408,943	\$ 152,244
Pharmaceutical	356,440	418,026
	<u>\$ 765,383</u>	<u>\$ 570,270</u>

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# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### Assets Whose Use is Limited

Assets whose use is limited are stated at fair value in the financial statements. These assets include investments designated by the Hospital Board for internal purposes and investments held by trustees for capital improvements. These investments consist primarily of cash and cash equivalents, certificates of deposit, mutual funds and federally-backed mortgage obligations. Investment income, to the extent not capitalized, is reported as nonoperating income in the consolidated statements of revenues, expenses and changes in net assets.

### Capital Assets and Depreciation

Capital assets such as property and equipment are stated at cost and include expenditures for new additions and other costs added to existing facilities which exceed \$500 and which substantially increase the useful lives of existing facilities. Maintenance, repairs and minor renewals are expensed as incurred.

The Hospital provides for depreciation of property and equipment using annual rates, which are sufficient to depreciate the cost of depreciable assets over their estimated useful lives using the straight-line method. The range of useful lives in computing depreciation is as follows:

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

### Advertising and Community Relations

The Hospital records advertising and community relations expense in the period incurred. Total expense for advertising and community relations was \$1,851,357 and \$2,083,418 for 2007 and 2006, respectively.

### Investment in Affiliates

During 2006, the Hospital had an equity interest in Hendricks Management Co., LLC. The investment was recorded on the equity method of accounting in the Hospital's consolidated financial statements. During 2006, Hendricks Management Co., LLC was dissolved.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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In January 2007, HAMCO was formed to manage the Hospital's outpatient surgery center. As the sole Class B member of HAMCO, the Hospital's voting rights are 50%. The Hospital does maintain control over certain decisions which may have a direct effect on the Hospital's charitable mission or tax exempt status. The Hospital maintains substantial participation in the operations of HAMCO in addition to an economic interest in HAMCO's financial position. The Hospital elected to consolidate HAMCO for financial reporting purposes.

### Net Assets

Net assets of the Hospital are classified in two components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt.

### Consolidated Statements of Revenues, Expenses and Changes in Net Assets

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

### Consolidated Statements of Cash Flows

For purposes of the consolidated statements of cash flows, cash and cash equivalents include all cash held in checking, savings, and money market accounts with original maturity dates of 90 days or less in current assets, board designated funds and trustee held 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. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue.

### Costs of Borrowing

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

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# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### Bond Issue Costs

The Hospital provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs were \$880,956 and \$1,076,376. Issue costs are amortized utilizing the straight-line method. Accumulated amortization as of December 31, 2007 and 2006 was \$32,442 and \$174,547, respectively. Amortization expense for the next five succeeding years will be \$38,788 per year. Bond issue costs are recorded in other assets on the consolidated balance sheets.

### Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, patient accounts receivable, assets whose use is limited, accounts payable, accrued liabilities, estimated third-party settlements and long-term debt. The carrying amounts reported in the balance sheets for cash and cash equivalents, patient accounts receivable, accounts payable, accrued liabilities and estimated third-party settlements approximate fair value.

The fair values of assets whose use is limited are estimated based on quoted market prices for those or similar investments. The fair value of the Hospital's long-term debt is estimated based on market prices for similar issues on current rates offered to the Hospital. As of December 31, 2007 and 2006, the carrying value of the Hospital's long-term debt approximated its fair value.

### Federal or State Income Taxes

The Hospital is a governmental instrumentality organized under Title 16, Article 12, of the Indiana statutes. The Hospital is exempt from federal income tax under Section 115 of the Internal Revenue Code of 1986 as a not-for-profit organization under Section 501(c)(3). Hendricks Regional Health Foundation, Inc. is a 501(c)(3) not-for-profit organization.

### Compensated Absences

The Hospital's employees earn time off at varying rates depending on years of service under separate policies for sick, vacation and personal leaves. The estimated amount of unused time off is reported as a liability in the consolidated financial statements.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### Reclassifications

Certain amounts from the 2006 consolidated financial statements have been reclassified to conform to the current year presentation.

### Litigation

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

### 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; employee health, dental, 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.

### Medical Malpractice

Malpractice insurance coverage is provided under a claims-made policy. Should the claims-made policy be terminated, the Hospital has the option to purchase insurance for claims having occurred during its term but reported subsequently. Prior to July 1, 1999, the Indiana Medical Malpractice Act provided for a maximum recovery of \$750,000 per occurrence (\$3,000,000 annual aggregate) for professional liability, \$100,000 of which would be paid through the Hospital's malpractice insurance coverage and the balance would be paid by the State of Indiana Patient Compensation Fund. For claims on or after July 1, 1999, the Indiana Medical Malpractice Act provides for a maximum recovery of \$1,250,000 per occurrence (\$7,500,000 annual aggregate) with the first \$250,000 covered by the Hospital's insurance and the remainder by the Fund.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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On July 1, 2006, the Hospital became a member in a captive insurance company, Suburban Health Organization Segregated Portfolio Company, LLC, to fund the Hospital's required portion of the professional and physician insurance coverage pursuant to the Act as well as its general liability insurance and excess coverage. This provides protection from liability in an amount not to exceed \$250,000 per incident and aggregate liability protection not to exceed \$7,500,000 per year. In addition, the Hospital maintains a commercial umbrella/excess liability policy with a limit of \$1,000,000 each occurrence, \$1,000,000 fire legal liability, \$1,000,000 personal and advertising injury, and a \$3,000,000 total policy aggregate.

### Accounting Pronouncement

In November 2005, the FASB issued FASB Staff Position No. 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners" ("FIN 45-3"). It served as an amendment to FASB Interpretation No. 45, "Guarantor's Accounting of Indebtedness of Others" ("FIN 45") by adding minimum revenue guarantees to the list of examples of contracts to which FIN 45 applies. FIN 45 is effective for new minimum revenue guarantees issued or modified on or after January 1, 2006.

The Hospital adopted this amendment to FIN 45 effective January 1, 2006. For periods ending before January 1, 2006, the Hospital did not report the fair value of its obligations under physician revenue guarantee agreements. However, under FIN 45 as amended, the Hospital is required to report the liability for these physician revenue guarantees on its balance sheets at fair value and amortize the related prepaid physician recruitment expense over the period of the physician's contractual commitment to practice in the local community, which is typically three years. The Hospital recognized an asset and corresponding liability of \$219,000 as of December 31, 2007 and 2006.

## 2. CHARITY CARE

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of services and supplies furnished under its charity care policy. The charity care charges provided during 2007 and 2006 was \$3,631,500 and \$2,808,292, respectively.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

### 3. CAPITAL ASSETS

Progressions for capital assets for 2007 and 2006 follow:

	December 31, 2006	Additions	Disposals	Transfers	December 31, 2007
Land	\$ 7,317,811	\$ 20,249	\$ (16,750)	\$ -0-	\$ 7,321,310
Land improvements	5,668,284	577,986	-0-	-0-	6,246,270
Buildings and fixed equipment	135,935,606	960,206	-0-	16,634,992	153,530,804
Major movable equipment	50,957,249	9,827,898	(2,535,289)	-0-	58,249,858
Construction in progress	14,163,535	6,247,412	-0-	(16,634,992)	3,775,955
Total capital assets	<u>214,042,485</u>	<u>17,633,751</u>	<u>(2,552,039)</u>	<u>-0-</u>	<u>229,124,197</u>
Less accumulated depreciation					
Land improvements	(2,105,022)	(253,522)	113	-0-	(2,358,431)
Buildings and fixed equipment	(43,921,932)	(5,195,896)	1,597,089	-0-	(47,520,739)
Major movable equipment	(31,892,456)	(5,753,575)	938,087	-0-	(36,707,944)
Total accumulated depreciation	<u>(77,919,410)</u>	<u>(11,202,993)</u>	<u>2,535,289</u>	<u>-0-</u>	<u>(86,587,114)</u>
Capital assets, net	<u>\$ 136,123,075</u>	<u>\$ 6,430,758</u>	<u>\$ (16,750)</u>	<u>\$ -0-</u>	<u>\$ 142,537,083</u>

	December 31, 2005	Additions	Disposals	Transfers	December 31, 2006
Land	\$ 7,316,752	\$ 1,059	\$ -0-	\$ -0-	\$ 7,317,811
Land improvements	5,597,079	71,205	-0-	-0-	5,668,284
Buildings and fixed equipment	130,707,530	1,366,695	(274,446)	4,135,827	135,935,606
Major movable equipment	47,101,683	6,022,872	(2,167,306)	-0-	50,957,249
Construction in progress	3,034,170	15,265,192	-0-	(4,135,827)	14,163,535
Total capital assets	<u>193,757,214</u>	<u>22,727,023</u>	<u>(2,441,752)</u>	<u>-0-</u>	<u>214,042,485</u>
Less accumulated depreciation					
Land improvements	(1,855,301)	(249,721)	-0-	-0-	(2,105,022)
Buildings and fixed equipment	(39,323,419)	(4,687,281)	88,768	-0-	(43,921,932)
Major movable equipment	(27,723,828)	(5,336,466)	1,167,838	-0-	(31,892,456)
Total accumulated depreciation	<u>(68,902,548)</u>	<u>(10,273,468)</u>	<u>1,256,606</u>	<u>-0-</u>	<u>(77,919,410)</u>
Capital assets, net	<u>\$ 124,854,666</u>	<u>\$ 12,453,555</u>	<u>\$ (1,185,146)</u>	<u>\$ -0-</u>	<u>\$ 136,123,075</u>

Depreciation and amortization expense for 2007 and 2006 was \$11,241,781 and \$10,312,256, respectively. There were no substantial construction contract commitments as of December 31, 2007 to expand and remodel facilities.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### 4. ASSETS WHOSE USE IS LIMITED

#### Board Designated Funds

The Hospital funds depreciation expense to meet the capital equipment needs of the facility. Depreciation is funded totally, with expenditures for capital equipment and debt principal payments reducing the funded depreciation balance. The Hospital designates other investments to fund specific projects. All interest earned by the funded depreciation and other board designated investments accounts are left to accumulate as an addition to the funds.

The following represents assets whose use is limited as of December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Board designated funds		
Cash and cash equivalents	\$ 2,135,218	\$ 3,704,552
Investments	52,172,034	47,848,594
Accrued interest receivable	19,528	427,228
	<u>\$ 54,326,780</u>	<u>\$ 51,980,374</u>

### 5. DEPOSITS AND INVESTMENTS

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

Investments are carried at fair market value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Funded depreciation investments consist of cash equivalents and U.S. Government securities. Market value approximated cost as of December 31, 2007 and 2006.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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

December 31, 2007

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Cash and cash equivalents	\$ 3,952,292	\$ 3,952,292	\$ -0-	\$ -0-	\$ -0-
Certificates of Deposit	814,258	189,816	624,442	-0-	-0-
Debt mutual funds	40,652,338	40,635,036	979	16,323	-0-
Equity mutual funds	9,430,186	9,430,186	-0-	-0-	-0-
	<u>\$ 54,849,074</u>	<u>\$ 54,207,330</u>	<u>\$ 625,421</u>	<u>\$ 16,323</u>	<u>\$ -0-</u>

December 31, 2006

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Cash and cash equivalents	\$ 5,269,180	\$ 5,269,180	\$ -0-	\$ -0-	\$ -0-
Certificates of Deposit	7,185,239	6,701,379	483,860	-0-	-0-
Debt mutual funds	31,931,253	31,888,644	3,296	39,313	-0-
Equity mutual funds	8,148,317	8,148,317	-0-	-0-	-0-
	<u>\$ 52,533,989</u>	<u>\$ 52,007,520</u>	<u>\$ 487,156</u>	<u>\$ 39,313</u>	<u>\$ -0-</u>

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

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

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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

	<u>2007</u>	<u>2006</u>
Carrying amount		
Deposits	\$ 8,618,490	\$ 5,245,874
Investments	54,849,074	52,533,989
	<u>\$ 63,467,564</u>	<u>\$ 57,779,863</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 8,618,490	\$ 5,245,874
Investments	522,294	553,615
Board designated funded depreciation investments	53,997,153	51,693,762
Other board designated investments	329,627	286,612
	<u>\$ 63,467,564</u>	<u>\$ 57,779,863</u>

### 6. LONG-TERM DEBT

In 2007, the Hospital issued Indiana Bond Bank Special Program Refunding Bonds, Series 2007A dated May 24, 2007 in the amount of \$44,915,000. The proceeds from the Series 2007A bonds were used to retire a significant portion of the Indiana Bond Bank Special Hospital Program Bonds Series 2002D bonds. The defeasance of the Series 2002D bonds resulted in a loss of approximately \$2,600,000 which is amortized straight line over the life of the bonds through 2030.

The Series 2007A bonds mature serially on an annual basis starting in April 2013 through April 2030 at interest rates ranging from 5.00% to 5.25%. Interest is due semi-annually on April 1 and October 1. Net revenues and certain assets held by the trustee to secure the tax-exempt revenue bonds.

The remaining Series 2002D bonds mature serially on an annual basis April 2012 at interest rates ranging from 4.00% to 5.00%. Interest is due semi-annually on April 1 and October 1. Net revenues and certain assets held by the trustee secure the tax-exempt revenue bonds.

The bonds require the Hospital to maintain certain financial debt coverage ratios. As of December 31, 2007 and 2006, the Hospital was in compliance with the debt coverage ratios.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Progressions for long-term debt for 2007 and 2006 include the following:

	December 31, 2006	Additional Borrowings	Payments	December 31, 2007	Current Portion
Indiana Bond Bank Special Hospital Program Bonds Series 2002D	\$ 55,430,000	\$ -0-	\$ (48,355,000)	\$ 7,075,000	\$ 1,295,000
Indiana Bond Bank Special Program Refunding Bonds Series 2007A	-0-	44,915,000	-0-	44,915,000	-0-
	55,430,000	\$ 44,915,000	\$ (48,355,000)	51,990,000	1,295,000
Unamortized loss on bond defeasance	(310,510)			(2,619,601)	-0-
Unamortized bond premium	491,366			4,925,736	-0-
	\$ 55,610,856			\$ 54,296,135	\$ 1,295,000
	December 31, 2005	Additional Borrowings	Payments	December 31, 2006	Current Portion
Indiana Bond Bank Special Hospital Program Bonds Series 2002D	\$ 56,630,000	\$ -0-	\$ (1,200,000)	\$ 55,430,000	\$ 1,245,000
Unamortized loss on bond defeasance	(360,192)			(310,510)	-0-
Unamortized bond premium	512,500			491,366	-0-
	\$ 56,782,308			\$ 55,610,856	\$ 1,245,000

Aggregate maturities of long-term debt are as follows:

Year Ending December 31,	Principal	Interest	Total
2008	\$ 1,295,000	\$ 2,650,425	\$ 3,945,425
2009	1,350,000	2,595,838	3,945,838
2010	1,405,000	2,532,025	3,937,025
2011	1,475,000	2,460,025	3,935,025
2012	1,550,000	2,384,400	3,934,400
2013-2017	8,685,000	10,675,413	19,360,413
2018-2022	11,180,000	8,102,588	19,282,588
2023-2027	14,435,000	4,758,469	19,193,469
2028-2031	10,615,000	854,831	11,469,831
	\$ 51,990,000	\$ 37,014,014	\$ 89,004,014

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### 7. NET PATIENT SERVICE REVENUE

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

#### Medicare

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

#### Medicaid

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

The Hospital is eligible for the Indiana Medicaid Supplemental programs including Medicaid Disproportionate Share Hospital and Municipal Upper Payment Limit programs. The Hospital recognized reimbursement from these programs within net patient revenue of approximately \$5,161,000 and \$2,334,000 during the years ended December 31, 2007 and 2006, respectively. These programs are administered by the state, but rely on Federal funding. There is currently a one year moratorium on a Federal regulation that could change certain aspects of these supplemental programs. If left unchanged the regulation would become effective in May 2008. The ultimate outcome and potential impact of the change in the regulation is unknown.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### Other Payors

The Hospital also has entered into payment agreements with certain commercial insurance carriers 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.

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

	<u>2007</u>	<u>2006</u>
Inpatient routine services	\$ 16,889,787	\$ 16,905,293
Inpatient ancillary services	61,058,976	61,530,200
Outpatient ancillary services	<u>200,450,591</u>	<u>167,535,859</u>
Gross patient service revenue	278,399,354	245,971,352
Contractual allowance	119,018,799	102,811,072
Charity care	3,631,500	2,808,292
Bad debts	10,919,039	9,328,908
Deductions from revenue	<u>129,937,838</u>	<u>112,139,980</u>
Net patient service revenue	<u>\$ 148,461,516</u>	<u>\$ 133,831,372</u>

## 8. DEFINED BENEFIT PENSION PLAN

### Plan Description

The Hospital has a defined benefit pension plan administered by National City Bank as authorized by IC 16-22-3-11. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The plan was established by written agreement between the Hospital Board of Trustees and the Plan Administrator. The Plan Administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

### Funding Policy

The contribution requirements of plan members are established by the written agreement between the Hospital Board of Trustees and the Plan Administrator. Plan members' contributions are not required by the plan agreement. The Hospital is required to contribute at an actuarially determined rate. The current rate is 1% of annual covered payroll.

The following is a summary of the plan as of December 31, 2007 and 2006:

	2007	2006
Annual required contribution	\$ 1,824,386	\$ 1,957,460
Interest on net pension obligation	28,990	36,349
Adjustment to annual required contribution	(52,383)	(65,500)
Annual pension cost	1,800,993	1,928,309
Contributions made	1,681,875	2,025,000
Change in net pension obligation	119,118	(96,691)
Net pension obligation, beginning of year	386,530	483,221
Net pension obligation, end of year	\$ 505,648	\$ 386,530

Actuarial valuation date	1/1/2007
Actuarial cost method	Frozen Entry Date
Amortization method	Level % of Payroll Projected
Remaining amortization period	3 Years
Asset valuation method	Market

### Actuarial assumptions

Investment rate of return	7.5%
Projected salary increases	
Total	6.0%
Attributed to inflation	Not Available
Attributed to merit/seniority	Not Available
Cost of living adjustments	Not Available

### Three Year Trend Information

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2005	\$ 1,739,737	103.5%	\$ 483,221
December 31, 2006	\$ 1,928,309	105.0%	\$ 386,530
December 31, 2007	\$ 1,800,993	93.4%	\$ 505,648

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### 9. TAX DEFERRED ANNUITY PLAN

#### Plan Description

The Hospital has a tax deferred annuity plan as authorized by IC 16-22-3-11. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The plan was established by written agreement between the Hospital Board of Trustees and the Plan Administrator. The Plan Administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan.

#### Funding Policy

The contribution requirements of plan members are established by the written agreement between the Hospital Board of Trustees and the Plan Administrator. Plan members may elect to contribute to the plan. The Hospital will contribute to each plan members' elective deferrals a matching amount up to a maximum percentage of each participant's annual compensation, to be determined at the discretion of the Board of Trustees.

The Hospital's contributions to the plan for 2007 and 2006 were \$1,421,761 and \$1,269,813, respectively.

### 10. RENTAL EXPENSE

The Hospital has leases expiring at various times through 2012. Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operating as incurred. Total rent expense for 2007 and 2006 was \$2,291,614 and \$1,749,836, respectively. Minimum future payments on leases for the years following December 31, 2007 are as follows:

<u>Year Ending December 31,</u>	
2008	\$ 975,441
2009	843,422
2010	460,003
2011	146,086
2012	19,190
	<u>\$ 2,444,142</u>

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### 11. CONCENTRATION OF CREDIT RISK

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

	<u>2007</u>	<u>2006</u>
Medicare	25%	26%
Medicaid	4%	4%
Blue Cross	17%	12%
Commercial	24%	28%
Self-Pay and other	30%	30%
	<u>100%</u>	<u>100%</u>

### 12. BLENDED COMPONENT UNITS

The Hospital's consolidated financial statements include the accounts of its Blended Component Units, HAMCO and Foundation. All significant related party transactions have been eliminated from the consolidated financial statements. The following is a summary of the financial position of HAMCO as of and for the years ended December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Capital assets	\$ 1,375,262	\$ -0-
Other assets	1,497,156	-0-
Total assets	<u>\$ 2,872,418</u>	<u>\$ -0-</u>
Total liabilities	\$ 111,973	\$ -0-
Net assets	2,760,445	-0-
Total liabilities and net assets	<u>\$ 2,872,418</u>	<u>\$ -0-</u>
Revenue	\$ 2,061,268	\$ -0-
Expenses	1,676,823	-0-
Excess revenue over expenses	<u>\$ 384,445</u>	<u>\$ -0-</u>

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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The following is a summary of the financial position of the Foundation as of and for the years ended December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Capital assets	\$ -0-	\$ 1,065,801
Other assets	302,654	633,290
Total assets	<u>\$ 302,654</u>	<u>\$ 1,699,091</u>
Amount payable to the Hospital	\$ -0-	\$ 6,600
Other liabilities	77,550	82,495
Total liabilities	<u>77,550</u>	<u>89,095</u>
Net assets	<u>225,104</u>	<u>1,609,996</u>
Total liabilities and net assets	<u>\$ 302,654</u>	<u>\$ 1,699,091</u>
Operating revenue	\$ 132,327	\$ 221,208
Nonoperating revenue	69,297	92,348
Other expenses	(1,511,659)	(598,173)
Depreciation expense	(74,857)	(109,606)
Change in net assets	<u>(1,384,892)</u>	<u>(394,223)</u>
Net assets, beginning of year	<u>1,609,996</u>	<u>2,004,219</u>
Net assets, end of year	<u>\$ 225,104</u>	<u>\$ 1,609,996</u>

### 13. SELF INSURANCE

The Hospital is self insured for employee health claims. A third party administrator processes the claims for the hospital. The Hospital maintains an estimated liability for the amount of claims incurred but not reported. The Hospital also maintains reinsurance including a stop loss for individual employees over \$125,000 a year. Substantially all employees are covered for major medical benefits. The total health claims expense was \$9,490,487 and \$9,087,577 for 2007 and 2006, respectively.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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

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

	<u>2007</u>	<u>2006</u>
Unpaid claims, beginning of year	\$ 1,634,570	\$ 1,081,045
Incurred claims and changes in estimates	9,490,487	9,087,577
Claim payments	<u>(9,200,057)</u>	<u>(8,534,052)</u>
Unpaid claims, end of year	<u>\$ 1,925,000</u>	<u>\$ 1,634,570</u>

### 14. PHYSICIAN RELOCATION AGREEMENTS AND OTHER MINIMUM REVENUE GUARANTEES

Consistent with the Hospital's policy on physician relocation and recruitment, the Hospital provides income guarantee agreements to certain physicians who agree to relocate to the community to fill a need in the Hospital's service area and commit to remain in practice there. Under such agreements, the Hospital is required to make payments to the physicians in excess of the amounts they earn in their practice up to the amount of the income guarantee. The income guarantee periods are typically one to three years. Such payments are recoverable from the physicians if they do not fulfill their commitment period to the community, which is typically three years. The Hospital also provides minimum revenue collection guarantees to Hospital-based physician groups providing certain services at the Hospital with terms ranging from one to three years. As of December 31, 2007 and 2006, the maximum potential amount of future payments under these guarantees was approximately \$600,000.

In accordance with FASB Staff Position FIN 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners," during the year ended December 31, 2007 and 2006, the Hospital recorded a liability of approximately \$219,000. For the fair value of new or modified guarantees entered into during this period with an offsetting asset recorded in other assets on the accompanying balance sheet, which will be amortized over the commitment period.

# HENDRICKS REGIONAL HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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### 15. COMMITMENTS AND CONTINGENCIES

In March 2005, the FASB issued Interpretation No. 47, Accounting for Condition and Retirement Obligations, an interpretation of FASB Statement 143. This interpretation elaborates on the disclosures to be made by an organization in its financial statements about its obligations related to asset retirements. The interpretation is effective for fiscal years ending after December 15, 2005. Management has evaluated the Interpretation and determined the impact to be immaterial to the consolidated financial statements.

### 16. 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 amounts reported in the consolidated balance sheets for cash and cash equivalents approximate its fair value.

Investments - Fair values, which are the amounts reported in the consolidated balance sheets, are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Assets whose use is limited - These assets consist primarily of cash and short-term investments, mutual funds and interest receivable. The carrying amounts reported in the consolidated balance sheets are fair value.

Accounts payable and accrued expenses - The carrying amounts reported in the consolidated balance sheets for accounts payable and accrued expenses approximate its fair value.

Estimated third-party payor settlements - The carrying amounts reported in the consolidated balance sheets for estimated third-party payor settlements approximate its fair value.

Long-term debt - The fair value of the Hospital's long-term debt – revenue bonds is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of the revenue bonds approximated \$56,710,000 and \$63,816,000 as of December 31, 2007 and 2006, respectively. The carrying value of the revenue bonds was \$51,990,000 and \$55,430,000 as of December 31, 2007 and 2006, respectively.

**SUPPLEMENTARY INFORMATION**

# HENDRICKS REGIONAL HEALTH

## CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2007

	Hospital	Foundation	HAMCO	Eliminations	Total
<b>Current assets</b>					
Cash and cash equivalents	\$ 7,452,517	\$ 219,183	\$ 946,790	\$ -0-	\$ 8,618,490
Investments	522,294	-0-	-0-	-0-	522,294
Patient accounts receivable, net	23,839,031	72,000	-0-	-0-	23,911,031
Inventories	516,172	-0-	249,211	-0-	765,383
Other current assets	941,726	-0-	216,155	(216,155)	941,726
Current portion of assets whose use is limited	1,295,000	-0-	-0-	-0-	1,295,000
Total current assets	34,566,740	291,183	1,412,156	(216,155)	36,053,924
<b>Assets whose use is limited</b>					
Board designated funded depreciation investments	53,997,153	-0-	-0-	-0-	53,997,153
Other board designated investments	329,627	-0-	-0-	-0-	329,627
Total assets whose use is limited	54,326,780	-0-	-0-	-0-	54,326,780
Less current portion	1,295,000	-0-	-0-	-0-	1,295,000
Noncurrent assets whose use is limited	53,031,780	-0-	-0-	-0-	53,031,780
<b>Capital assets</b>					
Land	7,321,310	-0-	-0-	-0-	7,321,310
Depreciable capital assets	221,232,505	-0-	1,723,276	(1,152,894)	221,802,887
	228,553,815	-0-	1,723,276	(1,152,894)	229,124,197
Less accumulated depreciation	86,469,679	-0-	348,014	(230,579)	86,587,114
Capital assets, net	142,084,136	-0-	1,375,262	(922,315)	142,537,083
<b>Other assets</b>					
Bond issuance costs, net	848,514	-0-	85,000	-0-	933,514
Physician recruitment and other assets	2,383,974	11,471	-0-	(2,128,422)	267,023
Total other assets	3,232,488	11,471	85,000	(2,128,422)	1,200,537
Total assets	\$ 232,915,144	\$ 302,654	\$ 2,872,418	\$ (3,266,892)	\$ 232,823,324

See report of independent auditors on pages 1 and 2.

# HENDRICKS REGIONAL HEALTH

## CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2007

	Hospital	Foundation	HAMCO	Eliminations	Total
<b>Current liabilities</b>					
Current portion of long-term debt	\$ 1,295,000	\$ -0-	\$ -0-	\$ -0-	\$ 1,295,000
Accounts payable	4,115,840	77,550	106,549	(216,155)	4,083,784
Accrued salaries and related liabilities	6,779,763	-0-	5,424	-0-	6,785,187
Accrued expenses and other current liabilities	4,211,636	-0-	-0-	-0-	4,211,636
Accrued interest	669,081	-0-	-0-	-0-	669,081
Estimated third-party settlements	300,000	-0-	-0-	-0-	300,000
<b>Total current liabilities</b>	<b>17,371,320</b>	<b>77,550</b>	<b>111,973</b>	<b>(216,155)</b>	<b>17,344,688</b>
<b>Long term liabilities</b>					
Long-term debt, net current portion	53,001,135	-0-	-0-	-0-	53,001,135
Physician recruitment liability	219,000	-0-	-0-	-0-	219,000
<b>Total long-term liabilities</b>	<b>53,220,135</b>	<b>-0-</b>	<b>-0-</b>	<b>-0-</b>	<b>53,220,135</b>
<b>Total liabilities</b>	<b>70,591,455</b>	<b>77,550</b>	<b>111,973</b>	<b>(216,155)</b>	<b>70,564,823</b>
<b>Minority interest</b>	<b>-0-</b>	<b>-0-</b>	<b>-0-</b>	<b>632,023</b>	<b>632,023</b>
<b>Net assets</b>					
Invested in capital assets, net of related debt	87,788,001	-0-	1,375,262	(922,315)	88,240,948
Unrestricted	74,535,688	225,104	1,385,183	(2,760,445)	73,385,530
<b>Total net assets</b>	<b>162,323,689</b>	<b>225,104</b>	<b>2,760,445</b>	<b>(3,682,760)</b>	<b>161,626,478</b>
<b>Total liabilities and net assets</b>	<b>\$ 232,915,144</b>	<b>\$ 302,654</b>	<b>\$ 2,872,418</b>	<b>\$ (3,266,892)</b>	<b>\$ 232,823,324</b>

See report of independent auditors on pages 1 and 2.

# HENDRICKS REGIONAL HEALTH

## CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2007

	Hospital	Foundation	HAMCO	Eliminations	Total
<b>Operating revenue</b>					
Net patient service revenue	\$ 148,461,516	\$ -0-	\$ 2,037,824	\$ (2,037,824)	\$ 148,461,516
Other revenue	3,180,573	132,327	-0-	-0-	3,312,900
Total operating revenue	151,642,089	132,327	2,037,824	(2,037,824)	151,774,416
<b>Operating expenses</b>					
Salaries and wages	65,167,154	-0-	133,592	-0-	65,300,746
Employee benefits	17,801,155	-0-	19,881	-0-	17,821,036
Professional medical fees	949,652	-0-	-0-	-0-	949,652
Other professional fees	9,489,395	-0-	-0-	(2,037,824)	7,451,571
Medical and surgical supplies	8,897,997	-0-	961,618	-0-	9,859,615
Drugs and intravenous solutions	4,623,976	-0-	133,957	-0-	4,757,933
Food	837,678	-0-	-0-	-0-	837,678
Purchased services	10,985,049	-0-	36,181	-0-	11,021,230
Equipment rental	2,291,614	-0-	2,708	-0-	2,294,322
Telephone and utilities	2,981,378	-0-	-0-	-0-	2,981,378
Depreciation and amortization	11,034,489	74,857	363,014	(230,579)	11,241,781
Insurance	1,246,648	-0-	3,750	-0-	1,250,398
Other supplies and expenses	4,595,271	134,788	22,122	-0-	4,752,181
Total operating expenses	140,901,456	209,645	1,676,823	(2,268,403)	140,519,521
Operating income (loss)	10,740,633	(77,318)	361,001	230,579	11,254,895
<b>Nonoperating income (expense)</b>					
Investment income and other	5,544,324	69,297	23,462	(1,449,316)	4,187,767
Interest expense	(2,338,571)	-0-	(18)	-0-	(2,338,589)
Total non operating income (expense), net	3,205,753	69,297	23,444	(1,449,316)	1,849,178
<b>Other changes in net assets</b>					
Minority interest	-0-	-0-	-0-	(88,023)	(88,023)
Contributions		-0-	2,376,000	(2,376,000)	-0-
Transfers	1,376,871	(1,376,871)	-0-	-0-	-0-
Total other changes in net assets	1,376,871	(1,376,871)	2,376,000	(2,464,023)	(88,023)
Change in net assets	15,323,257	(1,384,892)	2,760,445	(3,682,760)	13,016,050
<b>Net assets</b>					
Beginning of year	147,000,432	1,609,996	-0-	-0-	148,610,428
End of year	<u>\$ 162,323,689</u>	<u>\$ 225,104</u>	<u>\$ 2,760,445</u>	<u>\$ (3,682,760)</u>	<u>\$ 161,626,478</u>

See report of independent auditors on pages 1 and 2.