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September 30, 2008

Board of Directors
Morgan Hospital and Medical Center
2209 John R. Wooden Drive
P.O. Box 1717
Martinsville, IN 46151

We have reviewed the audit report prepared by Blue & Co., 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 Morgan Hospital and Medical Center, 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

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**MORGAN HOSPITAL AND MEDICAL CENTER
AND AFFILIATED ORGANIZATIONS**

CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2007 AND 2006

CPAS ADVISORS



**MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED
ORGANIZATIONS**

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DECEMBER 31, 2007 AND 2006

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Morgan Hospital and Medical Center
Martinsville, Indiana

We have audited the accompanying consolidated balance sheets of Morgan Hospital and Medical Center and Affiliated Organizations (the "Medical Center"), component units of Morgan County, as of December 31, 2007 and 2006, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Medical Center'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 the auditing standards generally accepted in the United States of America 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 financial position of the Medical Center as of December 31, 2007 and 2006, and the results of its operations and changes in net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages i through 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 of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Blue & Co., LLC

April 22, 2008

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

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

Management's discussion and analysis of Morgan Hospital & Medical Center and Affiliated Organizations (the "Medical Center") presents information concerning the financial performance during the years ended December 31, 2007 and 2006. This management discussion and analysis includes the activities and results of Morgan Hospital & Medical Center (the "Hospital") and its related entities, which are included in the Consolidated Financial Statements of the Hospital.

The Hospital is located in Martinsville (Morgan County), Indiana and consists of a campus that houses the main Hospital and a physician practice (Morgan Health Services, Inc.) ("MHS"), along with three off-site physician practices (Morgantown, Mooresville, and Martinsville), and a specialty physician practice (Morgan Physician Specialists, LLC) ("MPS").

FINANCIAL HIGHLIGHTS

The Medical Center's net assets decreased \$2,520,269 from 2006 to 2007 which includes a loss from operations of \$909,203 and non-operating expenses of \$1,611,066.

- For the year ended December 31, 2007, the Medical Center's total operating revenues decreased 4.9% to \$49,017,195 and expenses increased 2.9% to \$49,926,398. Income from operations decreased \$3,927,923 to \$909,203. The decrease in income from operations can be attributed to decreased net patient service revenue due to a decline in inpatient admissions and shifting growth to outpatient services.
- During 2007, the revenues in the Bridges Unit increased \$214,835 while revenues in the remaining inpatient units decreased. Outpatient revenue increased in the ED, surgery, laboratory, imaging and respiratory departments.

FINANCIAL STATEMENTS

The Consolidated Financial Statements of the Medical Center present information about the Medical Center using financial reporting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information. The Consolidated Balance Sheets include all of the Medical Center's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to the Medical Center's creditors (liabilities). It also provides the basis for compiling rate of return, evaluating the capital structure of the Medical Center and assessing the liquidity and financial flexibility of the Medical Center. All of the current and prior year's revenues and expenses are accounted for in the Consolidated Statements of Operations and Changes in Net Assets. These statements measure the financial results of the Medical Center's operations and present revenues earned and expenses incurred. The Consolidated Statements of Cash Flows provide information about the Medical Center's cash flows from operating activities, capital and related financing activities, and investing activities, plus provide information on the sources and uses of cash during both the current and prior year.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

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

FINANCIAL ANALYSIS

The Consolidated Balance Sheets and the Consolidated Statements of Operations and Changes in Net Assets report information about the Medical Center's activities. These two statements report the net assets of the Medical Center and its changes. Increases or decreases in the Medical Center's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, population changes (including uninsured and medically indigent individuals and families) and new or changed governmental legislation should also be considered.

A summary of the Medical Center's Consolidated Balance Sheets as of December 31, 2007 and 2006, is presented below:

	<u>2007</u>	<u>2006</u>	<u>\$ Change</u>	<u>% Change</u>
Cash and investments	\$ 17,582,504	\$ 17,726,526	\$ (144,022)	-0.8%
Capital assets	25,067,393	24,374,515	692,878	2.8%
Other assets	<u>10,051,638</u>	<u>12,280,651</u>	<u>(2,229,013)</u>	-18.2%
 Total assets	 <u>\$ 52,701,535</u>	 <u>\$ 54,381,692</u>	 <u>\$ (1,680,157)</u>	 -3.1%
 Long-term debt, including current portion	 \$ 18,503,340	 \$ 18,310,891	 \$ 192,449	 1.1%
Other current and noncurrent liabilities	<u>6,090,032</u>	<u>5,442,369</u>	<u>647,663</u>	11.9%
 Total liabilities	 24,593,372	 23,753,260	 840,112	 3.5%
 Net assets				
Investment in capital assets net of related debt	6,564,053	6,063,624	500,429	8.3%
Restricted for donor-designated purposes	27,626	27,626	-0-	0.0%
Unrestricted	<u>21,516,484</u>	<u>24,537,182</u>	<u>(3,020,698)</u>	-12.3%
 Total net assets	 <u>28,108,163</u>	 <u>30,628,432</u>	 <u>(2,520,269)</u>	 -8.2%
 Total liabilities and net assets	 <u>\$ 52,701,535</u>	 <u>\$ 54,381,692</u>	 <u>\$ (1,680,157)</u>	 -3.1%

As can be seen from the table above, net assets decreased in 2007 to \$28,108,163. The change in net assets resulted from losses from operations of \$909,203 and non-operating expenses of \$1,611,066 of which \$932,745 was interest expense, \$922,452 was investment income, \$719,290 was the change in value of interest rate swaps, and the remainder was from loss on disposal of capital assets and other expenses.

**MORGAN HOSPITAL AND MEDICAL CENTER
AND AFFILIATED ORGANIZATIONS**

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

FINANCIAL ANALYSIS

A summary of the Medical Center's Consolidated Statements of Operations for the years ended December 31, 2007 and 2006, is presented below:

	<u>2007</u>	<u>2006</u>	<u>\$ Change</u>	<u>% Change</u>
Operating revenues				
Net patient service revenue	\$ 48,310,409	\$ 50,853,250	\$ (2,542,841)	-5.0%
Other revenue	<u>706,786</u>	<u>676,709</u>	<u>30,077</u>	4.4%
Total operating revenues	49,017,195	51,529,959	(2,512,764)	-4.9%
Operating expenses				
Salaries and benefits	29,205,651	28,307,358	898,293	3.2%
Supplies and other	16,991,995	16,810,169	181,826	1.1%
Depreciation and amortization	<u>3,728,752</u>	<u>3,393,712</u>	<u>335,040</u>	9.9%
Total operating expenses	<u>49,926,398</u>	<u>48,511,239</u>	<u>1,415,159</u>	2.9%
Income (loss) from operations	(909,203)	3,018,720	(3,927,923)	-130.1%
Nonoperating revenues (expenses)	<u>(1,611,066)</u>	<u>215,420</u>	<u>(1,826,486)</u>	-847.9%
Change in net assets	<u>\$ (2,520,269)</u>	<u>\$ 3,234,140</u>	<u>\$ (5,754,409)</u>	-177.9%
Net assets, end of year	<u>\$ 28,108,163</u>	<u>\$ 30,628,432</u>	<u>\$ (2,520,269)</u>	-8.2%

Additional information concerning the changes from above is discussed under the Operating and Financial Performance section of the Management's Discussion and Analysis.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

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

SOURCES OF REVENUE

During the year ended December 31, 2007, the Medical Center derived substantially all of its revenues from patient services and other related activities. Revenues include, among other items, revenues from the Medicare and Medicaid programs, insurance carriers, and patients. The table below presents the percentage of gross revenue for patient services, by payor, for the years ended December 31, 2007 and 2006.

<u>Payor Mix</u>	<u>2007</u>	<u>2006</u>
Medicare	40.9 %	33.1 %
Medicaid	13.6	14.7
Blue Cross	15.9	13.8
Other third-party payors	23.1	31.0
Self-pay	6.5	7.4
Total	<u>100.0 %</u>	<u>100.0 %</u>

The Medical Center provides care under payment arrangements with Medicare, Medicaid and various commercial insurance carriers. Services provided under those arrangements are paid at predetermined rates or discounts from gross charges. Provisions have been made in the consolidated financial statements for contractual adjustments, which represent the difference between the standard charges for services and the actual or estimated payment.

OPERATING AND FINANCIAL PERFORMANCE

Overall, the Medical Center's financial performance declined in 2007 compared to 2006. This section will discuss highlights of 2007 operations and changes in activity.

Revenues

Net patient service revenues decreased 5.0% in 2007 primarily as a result of fewer inpatient admissions, unfavorable changes in payor mix, and growth in outpatient care procedures provided. Further discussion follows:

- Inpatient activity levels as measured by admissions decreased by 231, or 8.9%. Total patient days decreased to 9,477, a decrease of 12.3%. The decrease was attributable to a decrease in patient admissions and length of stay in all inpatient units. The decreased admissions are partly attributed to the loss of physicians and an industry trend toward less inpatient utilization.
- Outpatient activity levels as measured by visits/registrations increased 2.8% for the Hospital and 7.8% MPS and MHS.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

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

- The provision for bad debts decreased \$268,528 or 2.7%, but increased as a percent of net patient service from 19.9% in 2006 to 20.4% in 2007. The Medical Center's provision for bad debts continues to remain high due to the economy in the region, higher deductibles and co-pays, and the increased number of uninsured patients.

Expenses

Total operating expenses increased by 2.9% or \$1,415,159. Further discussion follows:

- Employee compensation and benefits increased \$898,293 or 3.2% as a result of merit increases (avg. 2.5%), and replacement of contract labor with permanent staff.
- Employee benefits decreased \$496,171 or 7.7% due mostly to a decrease in healthcare claims between years.
- Supplies and other expenses increased \$181,826 or 1.1% as a result of increased inflation in supply and drug costs and purchased services costs. The increases, however, were offset by decreased supply and variable costs associated with volume declines in inpatient services.

Capital Assets

During 2007, the Medical Center invested \$5,258,774 in a broad range of capital assets included in the table below:

	2007	2006	\$Change	%Change
Land and land improvements	\$ 2,231,328	\$ 2,186,722	\$ 44,606	2.0%
Buildings	22,549,914	22,070,318	479,596	2.2%
Equipment	37,092,091	34,558,608	2,533,483	7.3%
Construction in progress	612,589	-0-	612,589	100.0%
	62,485,922	58,815,648	3,670,274	6.2%
Less accumulated depreciation	(37,418,529)	(34,441,133)	(2,977,396)	8.6%
Capital assets, net	<u>\$ 25,067,393</u>	<u>\$ 24,374,515</u>	<u>\$ 692,878</u>	2.8%

Gross capital assets have increased due to the addition of the new software modules and computer hardware related to the final phases of the Meditech installation; upgrades to anesthesia machines, purchase of new patient beds, and various pieces of radiology equipment.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

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

The Medical Center budgeted \$4,954,577 for 2007 capital expenditures. The negative variance from actual of \$304,197 was primarily due to unforeseen capital needs.

Long-Term Debt

At the end of the 2007 fiscal year, the Medical Center had long-term debt (including current portion) of \$18,503,340. Included in this amount is \$13,044,170 of bonds payable that are secured by a letter of credit with a bank. The bank's letter of credit securing the bonds will expire in December 2008, unless extended or earlier terminated.

ECONOMIC FACTORS AND 2008 BUDGET

The Medical Center's Board and management considered many factors when establishing the 2008 Budget. Included was the status of the economy, which takes into account market factors and other environmental factors such as the following items:

- Population growth of Morgan County, Indiana and the expanding need for services
- Advances in medical equipment and information systems technology and the need to replace obsolete equipment
- Decreasing reimbursement from governmental and commercial insurance payors
- Increasing number of uninsured and/or indigent patients
- Increasing costs of medical supplies, pharmaceuticals, and medical malpractice insurance
- Nationwide workforce shortages in key nursing and other healthcare specialist positions
- Increasing awareness and expectations from the public on the quality of services
- Increased competition from niche providers

CONTACTING THE MEDICAL CENTER'S CHIEF FINANCIAL OFFICER

This report is designed to provide our citizens, customers, and creditors with a general overview of the Medical Center's finances. These consolidated financial statements include the activities of the Hospital, MHS, MPS, and Morgan County Memorial Hospital Foundation, Inc. Separately-issued audited financial statements are available for both MHS and MPS. If you have questions about this report or need additional information, contact the Chief Financial Officer, Susan Havers, at 765-349-6506.

**MORGAN HOSPITAL AND MEDICAL CENTER
AND AFFILIATED ORGANIZATIONS**

**CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2007 AND 2006**

ASSETS	<u>2007</u>	<u>2006</u>
Current assets		
Cash and cash equivalents	\$ 2,586,462	\$ 3,347,876
Certificates of deposit	2,269,416	2,400,000
Patient accounts receivable, net of estimated uncollectibles of \$4,266,429 in 2007 and \$5,873,559 in 2006	7,418,689	9,505,831
Other receivables	323,430	204,179
Inventories	1,102,160	793,072
Prepaid expenses	529,116	550,765
Estimated third party payor settlements	300,000	225,000
Current portion of other assets	20,490	503,627
Total current assets	<u>14,549,763</u>	<u>17,530,350</u>
Assets whose use is limited, net of amount required to meet current obligations	12,726,626	11,978,650
Capital assets		
Land	1,697,186	1,697,186
Land improvements	534,142	489,536
Buildings	22,549,914	22,070,318
Fixed equipment	5,652,648	5,634,742
Movable equipment	<u>31,439,443</u>	<u>28,923,866</u>
	61,873,333	58,815,648
Less accumulated depreciation	<u>37,418,529</u>	<u>34,441,133</u>
	24,454,804	24,374,515
Construction in progress	<u>612,589</u>	<u>-0-</u>
Capital assets, net	25,067,393	24,374,515
Other assets	<u>357,753</u>	<u>498,177</u>
Total assets	<u>\$ 52,701,535</u>	<u>\$ 54,381,692</u>

See accompanying notes to consolidated financial statements.

**MORGAN HOSPITAL AND MEDICAL CENTER
AND AFFILIATED ORGANIZATIONS**

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2007 AND 2006

LIABILITIES AND NET ASSETS

	2007	2006
Current liabilities		
Accounts payable	\$ 1,722,945	\$ 1,375,243
Accrued payroll and payroll withholdings	1,307,384	1,128,431
Accrued expenses	1,684,023	2,403,305
Current portion of obligations under capital leases	1,829,419	1,407,473
Current portion of long-term debt	468,106	448,105
Total current liabilities	7,011,877	6,762,557
 Long-term liabilities		
Obligations under capital leases, net of current portion	3,629,751	3,411,142
Long-term debt, net of current portion	12,576,064	13,044,171
Interest rate swaps	770,680	51,390
Other	605,000	484,000
Total long-term liabilities	17,581,495	16,990,703
 Total liabilities	24,593,372	23,753,260
 Net assets		
Invested in capital assets net of related debt	6,564,053	6,063,624
Restricted		
Expendable for donor-designated purposes	27,626	27,626
Unrestricted	21,516,484	24,537,182
Total net assets	28,108,163	30,628,432
 Total liabilities and net assets	\$ 52,701,535	\$ 54,381,692

See accompanying notes to consolidated financial statements.

**MORGAN HOSPITAL AND MEDICAL CENTER
AND AFFILIATED ORGANIZATIONS**

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

	2007	2006
Operating revenues		
Net patient service revenue	\$ 48,310,409	\$ 50,853,250
Other revenue	706,786	676,709
Total operating revenues	49,017,195	51,529,959
Operating expenses		
Salaries and wages	23,267,594	21,873,130
Employee benefits and payroll taxes	5,938,057	6,434,228
Professional medical fees	68,936	96,168
Medical supplies	2,618,824	3,046,611
Other supplies	1,001,291	766,810
Drugs	2,599,315	2,750,442
Purchased services	6,581,587	6,163,236
Utilities	904,659	1,124,460
Insurance	672,802	637,427
Depreciation and amortization	3,728,752	3,393,712
Rent	678,628	498,168
Other operating expenses	1,865,953	1,726,847
Total operating expenses	49,926,398	48,511,239
Income (loss) from operations	(909,203)	3,018,720
Nonoperating revenues (expenses)	(1,611,066)	215,420
Change in net assets	(2,520,269)	3,234,140
Net assets, beginning of year	30,628,432	27,394,292
Net assets, end of year	\$ 28,108,163	\$ 30,628,432

See accompanying notes to consolidated financial statements.

**MORGAN HOSPITAL AND MEDICAL CENTER
AND AFFILIATED ORGANIZATIONS**

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

	2007	2006
Operating activities		
Cash received for patient services	\$ 50,203,300	\$ 54,587,041
Cash paid to/for employees	(29,026,698)	(28,212,871)
Cash paid to vendors and suppliers	(17,058,105)	(16,267,881)
Other receipts, net	706,786	676,709
Net cash flows from operating activities	4,825,283	10,782,998
Capital and related financing activities		
Principal payments on obligations under capital leases	(1,866,661)	(1,372,884)
Principal payments on long-term debt	(455,000)	(440,000)
Interest expense on long-term debt	(932,745)	(855,800)
Purchases of capital assets	(2,487,169)	(3,374,825)
Change in bond discount	6,894	41,723
Proceeds from sale of capital assets	3,640	2,278
Net cash flows from capital and related financing activities	(5,731,041)	(5,999,508)
Investing activities		
Investment income	203,162	1,034,408
Change in certificates of deposit	(269,416)	(2,000,000)
Change in assets whose use is limited	(642,872)	(2,441,973)
Other nonoperating revenues (expenses)	(881,483)	36,812
Change in interest rate swaps	719,290	26,912
Change in other long-term liabilities	121,000	-0-
Change in other assets	599,767	(682,236)
Net cash flows from investing activities	(150,552)	(4,026,077)
Net change in cash and cash equivalents	(1,056,310)	757,413
Cash and cash equivalents, beginning of year	6,225,266	5,467,853
Cash and cash equivalents, end of year	\$ 5,168,956	\$ 6,225,266
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents in current assets	\$ 2,586,462	\$ 3,347,876
Cash and cash equivalents in certificates of deposit	-0-	400,000
Cash and cash equivalents in assets whose use is limited	2,582,494	2,477,390
Total cash and cash equivalents	\$ 5,168,956	\$ 6,225,266

See accompanying notes to consolidated financial statements.

**MORGAN HOSPITAL AND MEDICAL CENTER
AND AFFILIATED ORGANIZATIONS**

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

	2007	2006
Reconciliation of income from operations to net cash and cash equivalents from operating activities		
Income (loss) from operations	\$ (909,203)	\$ 3,018,720
Adjustments to reconcile income (loss) from operations to net cash flows from operating activities		
Depreciation	3,704,958	3,360,885
Amortization	23,794	32,827
Provision for bad debts	9,845,478	10,114,006
Loss on disposal of capital assets	857,298	15,151
Changes in operating assets and liabilities		
Patient accounts receivable	(7,758,336)	(10,104,489)
Other receivables	(119,251)	3,969,274
Inventories	(309,088)	(125,241)
Prepaid expenses	21,649	(97,908)
Accounts payable	83,313	(44,021)
Accrued payroll and payroll withholdings	178,953	94,487
Accrued expenses	(719,282)	794,307
Estimated third party payor settlements	(75,000)	(245,000)
Net cash flows from operating activities	\$ 4,825,283	\$ 10,782,998
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	\$ 945,495	\$ 869,456
Supplemental disclosures of noncash capital and related financing activities		
Capital assets acquired included in accounts payable	\$ 264,389	\$ -0-
Capital assets acquired under capital leases	\$ 2,507,216	\$ -0-

See accompanying notes to consolidated financial statements.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007 AND 2006

1. NATURE OF OPERATIONS

Morgan Hospital and Medical Center (the "Hospital") is a not-for-profit, acute care hospital located in Martinsville, Indiana. The Hospital is county owned and operates under the Indiana County Hospital Law, Indiana Code 16-22 for the purpose of providing healthcare services to the residents of Morgan County and the surrounding area. The Hospital's primary sources of support are from patient revenues, investment income, and management fee income. Patient revenues include funds received from Medicare, state agencies, insurance companies, and the patients themselves.

Morgan Health Services, Inc. ("MHS") is a not-for-profit corporation located in Martinsville, Indiana. MHS was organized to manage the practices of physicians that are affiliated with the Hospital. MHS's primary source of support is from patient revenues.

Morgan Physician Specialists, LLC ("MPS") consists of surgical and specialty physician practices located in Martinsville, Indiana. MPS was organized for the purpose of acquiring and holding multi-specialty physician practices to serve the residents of Morgan County and the surrounding area. MPS's primary source of support is from patient revenues.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by the Hospital, MHS, and MPS (collectively the "Medical Center") in the preparation of the consolidated financial statements are summarized below:

Morgan County Memorial Hospital Foundation, Inc.

The Medical Center's consolidated financial statements at December 31, 2007 and 2006, include the accounts of the Morgan County Memorial Hospital Foundation, Inc. (the "Foundation"). The Foundation is a blended component unit of the Hospital.

Reporting Entity and Consolidation Policy

The accompanying consolidated financial statements include the accounts of the Hospital, MHS, MPS, and the Foundation. The Board of County Commissioners of Morgan County appoints the governing Board of Trustees of the Hospital, and a financial benefit/burden relationship exists between the Hospital and the Morgan County government. For these reasons, the Hospital is considered a component unit of Morgan County. Similarly, due to their organized purposes, the Foundation, MHS, and MPS are considered blended component units of the Hospital.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Intercompany transactions and balances have been eliminated in consolidation. The separate financial statements of MHS, MPS, and the Foundation may be obtained through contacting the Hospital as follows:

Morgan Hospital and Medical Center
2209 John R. Wooden Drive
Martinsville, IN 46151

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.

Proprietary Fund Accounting

The Medical Center utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis of accounting using the economic resources measurement focus. Substantially all revenues and expenses are subject to accrual.

Accounting Standards

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

Risk Management

The Medical Center is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The Medical Center is insured for medical malpractice claims and judgments.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Cash and Cash Equivalents

Cash and cash equivalents as reported on the consolidated balance sheets include petty cash and other cash on hand amounts, checking accounts, and savings accounts that are readily available for use.

Cash and cash equivalents as reported on the consolidated statements of cash flows include investments in highly liquid assets with maturity dates of 90 days or less when purchased.

Patient Accounts Receivable and Net Patient Service Revenue

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 the estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are estimated and accrued in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Allowance for Patient Uncollectible Accounts

The Medical Center 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 Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes; assets that have been restricted by donors for specific purposes; and insurance benefit plan assets related to an executive deferred compensation agreement.

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 realized gains and losses on investments, net change in the market value of assets whose use is limited, interest, and dividends, is included in nonoperating revenues (expenses) when earned.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

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Capital Assets

The Medical Center's capital assets are reported at historical cost and include expenditures for additions and repairs which substantially increase the useful lives of capital assets. Maintenance, repairs, and minor improvements are expensed as incurred. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land and construction in progress are depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association Guide for Estimated Useful Lives for Fixed Assets.

Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Other Assets

Other assets consist of notes receivable due from physicians, employees, and prior employees, bond issues costs, intangible assets relating to physician income guarantees, covenants not to compete and goodwill relating to the purchase of physician practices. Bond issue costs are being amortized over the lives of the bonds on the straight-line method, and goodwill is being amortized over a 12-year period using the straight-line method.

Net Assets

Net assets of the Medical Center are classified in four components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net assets* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center, including amounts deposited with trustees as required by revenue bond indentures. *Restricted nonexpendable net assets* equal the principal portion of permanent endowments, if any. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt* or *restricted*.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Consolidated Statement of Operations and Changes in Net Assets

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenues and expenses. Peripheral and incidental transactions are reported as nonoperating revenues (expenses). Nonoperating revenues (expenses) which are excluded from income (loss) from operations include interest expense, investment income, contributions, and net change in the market value of assets whose use is limited.

Charity Care

The Medical Center 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 reductions in net patient service revenue.

Advertising and Public Relations Costs

Advertising and public relations costs are charged to operations when incurred. Advertising and public relations costs charged to operations were \$863,850 and \$747,170 for the years ended December 31, 2007 and 2006, respectively.

Income Taxes

The Hospital, Foundation and MHS are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from income taxes on related income pursuant to Section 501(a) of the Code. MPS is organized as a single-member Limited Liability Company (LLC). The Hospital is the sole member of MPS. As such, MPS is not required to file a separate State or Federal tax return.

Grants and Contributions

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Reclassifications

Certain 2006 amounts have been reclassified to provide for consistency with reporting of 2007 information. These reclassifications have no effect on the previously reported change in net assets or net assets.

3. **BANK DEPOSITS AND INVESTMENTS**

Deposits and investments are comprised of the following at December 31, 2007 and 2006:

	2007	2006
Carrying amount		
Cash and cash equivalents	\$ 5,168,956	\$ 5,825,266
Certificates of deposit	2,453,422	2,614,535
Equity mutual funds	7,973,976	7,546,516
Bond mutual funds	1,986,150	1,740,209
Total	\$ 17,582,504	\$ 17,726,526

	2007	2006
Included in the consolidated balance sheet captions:		
Cash and cash equivalents	\$ 2,586,462	\$ 3,347,876
Certificates of deposit	2,269,416	2,400,000
Assets whose use is limited	12,726,626	11,978,650
Total	\$ 17,582,504	\$ 17,726,526

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Custodial Credit Risk – Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the Medical Center's deposits may not be returned to it. The Medical Center does not have a deposit policy for custodial credit risk. Deposits with financial institutions are insured by the Federal Depository Insurance Corporation ("FDIC") up to the FDIC limits. This includes any deposit accounts issued or offered by a qualifying institution. The Medical Center's deposits with financial institutions in the State of Indiana for the years ended December 31, 2007 and 2006, were entirely insured by the FDIC or by the Indiana Public Deposit Insurance Fund.

Investments are carried at fair market value or cost which approximates fair value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. As of December 31, 2007 and 2006, the Medical Center had the following investments and maturities, all of which were held in the Medical Center's name by custodial banks or investment companies that are agents of the Medical Center:

	December 31, 2007				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
Certificates of deposit	\$ 2,453,422	\$ 2,453,422	\$ -0-	\$ -0-	\$ -0-

	December 31, 2006				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
Certificates of deposit	\$ 2,614,535	\$ 2,614,535	\$ -0-	\$ -0-	\$ -0-

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

The Medical Center does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

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Credit Risk – Investments

Credit risk is the risk that, in the event of a failure of a financial institution, the Medical Center would not be able to recover deposits, the value of its investments, or collateral securities that are in the possession of an outside party.

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

Concentration of Credit Risk

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

4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable reported as current assets at December 31, 2007 and 2006 consist of the following:

	<u>2007</u>	<u>2006</u>
Receivable from Medicare	\$ 923,346	\$ 2,061,695
Receivable from Medicaid	183,561	252,158
Receivable from Blue Cross	1,035,941	1,094,123
Receivable from other insurance carriers	2,865,273	3,576,192
Receivable from patients	<u>6,676,997</u>	<u>8,395,222</u>
Total patient accounts receivable	11,685,118	15,379,390
Less allowance for uncollectible amounts	<u>4,266,429</u>	<u>5,873,559</u>
Patient accounts receivable, net	<u>\$ 7,418,689</u>	<u>\$ 9,505,831</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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5. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited are reported at market value and include the following at December 31, 2007 and 2006:

	2007	2006
Board-designated funds		
Cash and cash equivalents	\$ 412,263	\$ 469,578
Certificates of deposit	184,006	214,535
Equity mutual funds	7,973,976	7,546,516
Bond mutual funds	1,986,150	1,740,209
Total board-designated funds	10,556,395	9,970,838
Building fund		
Cash and cash equivalents	1,537,605	1,496,186
Insurance benefit plan assets		
Cash and cash equivalents	605,000	484,000
Donor-restricted funds		
Cash and cash equivalents	27,626	27,626
Assets whose use is limited	\$ 12,726,626	\$ 11,978,650

Board-Designated Funds

The Medical Center's Board of Trustees approved the funding of depreciation expense to meet the capital equipment replacement needs of the facility. Depreciation is funded totally with expenditures for capital equipment reducing the funded depreciation balance. Board-designated funds also include amounts intended for specific purposes, as established by the Medical Center's Board. All income earned by the board-designated accounts is left to accumulate as additions to the funds. Board-designated funds remain under the control of the Board which may at its discretion later use the funds for other purposes. Therefore, all board-designated funds are included in unrestricted net assets.

Building Fund

The Medical Center's Board of Trustees established a building fund to reserve amounts for the construction or purchase of medical facilities or other long term capital projects. All income earned by the Building Fund account is left to accumulate as an addition to the fund.

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Insurance Benefit Plan Assets

The insurance benefit plan assets are equal to the amount of premiums paid for an executive insurance benefit program.

Donor-Restricted Funds

Donor-restricted funds represent donations that have been restricted by donors for specific purposes.

6. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2007 and 2006, was as follows:

	2007			
	Beginning Balance	Additions	Retirements / Transfers	Ending Balance
Land	\$ 1,697,186	\$ -0-	\$ -0-	\$ 1,697,186
Land improvements	489,536	44,606	-0-	534,142
Buildings	22,070,318	479,596	-0-	22,549,914
Fixed equipment	5,634,742	47,644	(29,738)	5,652,648
Movable equipment	28,923,866	4,074,339	(1,558,762)	31,439,443
Construction in progress	-0-	612,589	-0-	612,589
Total historical cost	<u>58,815,648</u>	<u>5,258,774</u>	<u>(1,588,500)</u>	<u>62,485,922</u>
Less accumulated depreciation for				
Land improvements	(319,006)	(23,768)	-0-	(342,774)
Buildings	(11,220,419)	(460,453)	-0-	(11,680,872)
Fixed equipment	(4,063,164)	(165,504)	29,527	(4,199,141)
Movable equipment	(18,838,544)	(3,055,233)	698,035	(21,195,742)
Total accumulated depreciation	<u>(34,441,133)</u>	<u>(3,704,958)</u>	<u>727,562</u>	<u>(37,418,529)</u>
Capital assets, net	<u>\$ 24,374,515</u>	<u>\$ 1,553,816</u>	<u>\$ (860,938)</u>	<u>\$ 25,067,393</u>

**MORGAN HOSPITAL AND MEDICAL CENTER
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	2006			
	Beginning Balance	Additions	Retirements / Transfers	Ending Balance
Land	\$ 1,547,186	\$ 52,591	\$ 97,409	\$ 1,697,186
Land improvements	489,536	-0-	-0-	489,536
Buildings	21,400,898	766,829	(97,409)	22,070,318
Fixed equipment	5,596,491	53,959	(15,708)	5,634,742
Movable equipment	26,710,946	2,501,446	(288,526)	28,923,866
Total historical cost	<u>55,745,057</u>	<u>3,374,825</u>	<u>(304,234)</u>	<u>58,815,648</u>
Less accumulated depreciation for				
Land improvements	(299,228)	(19,778)	-0-	(319,006)
Buildings	(10,768,076)	(457,619)	5,276	(11,220,419)
Fixed equipment	(3,909,588)	(169,284)	15,708	(4,063,164)
Movable equipment	(16,390,161)	(2,714,204)	265,821	(18,838,544)
Total accumulated depreciation	<u>(31,367,053)</u>	<u>(3,360,885)</u>	<u>286,805</u>	<u>(34,441,133)</u>
Capital assets, net	<u>\$ 24,378,004</u>	<u>\$ 13,940</u>	<u>\$ (17,429)</u>	<u>\$ 24,374,515</u>

7. OTHER ASSETS

At December 31, 2007 and 2006, other assets consist of the following:

	2007	2006
Notes receivable, net	\$ 20,490	\$ 125,093
Covenants not to compete, net	-0-	6,250
Intangible asset - physician income guarantee	-0-	467,958
Bond issue costs, net	273,403	290,303
Goodwill, net	84,350	112,200
Less: current portion of other assets	<u>(20,490)</u>	<u>(503,627)</u>
Other assets, net of current portion	<u>\$ 357,753</u>	<u>\$ 498,177</u>

The Medical Center recognized an impairment loss on goodwill due to the departure of certain physicians of \$72,948 for the year ended December 31, 2006. The impairment loss is recorded in depreciation and amortization expense on the Consolidated Statements of Operations and Changes in Net Assets.

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8. COMPENSATED ABSENCES

The Medical Center provides a paid time off (PTO) policy to employees for vacation, personal days, and holidays. Upon employment, full and part-time employees accrue PTO from the date of hire to a maximum limit of 600 hours. After completion of 30 days of service, full and part-time employees qualify for PTO with pay for the total amount accrued. The amount earned is based upon the number of eligible hours (regular hours, paid sick hours, paid time off hours and flex hours) each employee has per pay period.

The rate at which employees earn PTO depends upon credited length of service, and is as follows:

<u>Length of Service</u>	<u>Earned per year</u>
0 – 5 years	26 days
6 – 14 years	31 days
15 or more years	36 days

PTO days are accrued when incurred and reported as accrued expenses in the consolidated financial statements. The PTO accrual at December 31, 2007 and 2006, was \$943,794 and \$926,199, respectively.

9. EMPLOYEE HEALTH BENEFIT PLAN

The Medical Center operates a self-funded health plan covering substantially all eligible employees. The Medical Center has an annual stop loss limit on the plan of \$110,000 per claim. 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. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of pay out, and other economic and social factors.

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Changes in the balances of claims liabilities during the years ended December 31, 2007 and 2006, were as follows:

	2007	2006
Accrued liability, beginning of year	\$ 456,779	\$ 454,986
Incurred claims and changes in estimates	2,916,105	3,741,694
Claim payments	(3,016,686)	(3,739,901)
Accrued liability, end of year	\$ 356,198	\$ 456,779

10. PENSION PLAN

The Medical Center sponsors separate defined contribution pension plans that cover all eligible employees who work over 1,000 hours a year. To be eligible for enrollment, employees must have completed one year of employment and be 21 years of age. The Hospital contributes for each eligible participant an amount equal to 7 percent of compensation that does not exceed 150 percent of the social security contribution. MHS annually determines the amount to contribute to their plan. This contribution is discretionary. MPS sponsors various defined contribution pension plans that cover all eligible employees (physicians) according to the terms of each physician's individual employment agreement. The Medical Center incurred expenses related to these plans of \$980,191 and \$885,893 for the years ended December 31, 2007 and 2006, respectively.

11. OBLIGATIONS UNDER CAPITAL LEASES

The Medical Center is the lessee of equipment under capital leases expiring in various years through 2012. The assets and liabilities under the capital lease are originally 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 the capital lease is included in depreciation expenses and was \$1,227,853 and \$1,024,535 for the years ended December 31, 2007 and 2006, respectively. The capital lease obligations carry imputed interest rates between 4.12 and 7.12 percent, and are collateralized by the leased equipment.

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Following is a summary of equipment held under capital leases:

	2007	2006
Equipment	\$ 7,207,743	\$ 4,700,527
Less: accumulated amortization	2,918,127	1,690,274
	\$ 4,289,616	\$ 3,010,253

Capital lease activity for the years ended December 31, 2007 and 2006, was as follows:

	2007				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Obligations under capital leases	\$ 4,818,615	\$ 2,507,216	\$ 1,866,661	\$ 5,459,170	\$ 1,829,419
	2006				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Obligations under capital leases	\$ 6,191,499	\$ -0-	\$ 1,372,884	\$ 4,818,615	\$ 1,407,473

Debt service requirements on obligations under capital leases at December 31, 2007, are as follows:

Year Ending December 31,	Principal	Interest
2008	\$ 1,829,419	\$ 222,350
2009	1,739,053	136,652
2010	1,204,383	58,297
2011	534,629	22,573
2012	151,686	2,913
Total	\$ 5,459,170	\$ 442,785

**MORGAN HOSPITAL AND MEDICAL CENTER
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12. LONG-TERM DEBT

At December 31, 2007 and 2006, the Medical Center was obligated for long-term debt agreements as follows:

	<u>2007</u>	<u>2006</u>
Economic Development Revenue Bonds, Series 2002A, dated December 17, 2002, payable in annual principal installments commencing December 1, 2003 through December 1, 2027, in amounts ranging from \$45,000 to \$95,000. Variable interest rate determined weekly (3.55% at December 31, 2007). Interest is paid in monthly installments. Secured by letter of credit from Fifth Third Bank.	\$ 1,460,000	\$ 1,510,000
Economic Development Revenue Bonds, Series 2002B, dated December 17, 2002, payable in annual principal installments commencing December 1, 2004 through December 1, 2027, in amounts ranging from \$255,000 to \$780,000. Variable interest rate determined weekly (3.50% at December 31, 2007); Interest is paid in monthly installments. Secured by letter of credit from Fifth Third Bank.	11,270,000	11,545,000
Floating Rate Demand Notes, Series 2002, dated December 17, 2002, payable in annual principal installments commencing December 1, 2003 through December 1, 2010, in the amounts ranging from \$95,000 to \$150,000. Variable interest rate determined weekly (5.03% at December 31, 2007). Interest is paid in monthly installments. Secured by letter of credit from Fifth Third Bank.	<u>430,000</u>	<u>560,000</u>
Total long-term debt	13,160,000	13,615,000
Less unamortized bond discounts	(115,830)	(122,724)
Less current portion	<u>(468,106)</u>	<u>(448,105)</u>
Long-term debt, net of current portion	<u>\$ 12,576,064</u>	<u>\$ 13,044,171</u>

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

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On December 17, 2002, Morgan County, Indiana issued \$14,030,000 of Adjustable Rate Demand Economic Development Revenue Bonds, Series 2002A and 2002B (the "Bonds") on behalf of the Medical Center. The proceeds of the Bonds were used to finance the acquisition, construction, and equipping of certain economic development facilities, including a new oncology center, a new medical office building and other capital improvements to the Medical Center; advance refund the Morgan County Hospital Association First Mortgage Revenue Refunding Bonds, Series 1993 and other loans and capital leases of the Medical Center; pay capitalized interest on the Series 2002 Bonds; and pay certain costs related to the issuance of the Series 2002 Bonds. The bank's letter of credit securing the Bonds will expire in December 2008, unless extended or earlier terminated.

The proceeds of the Series 2002 Notes were used to acquire property in Johnson County, Indiana, and were secured by a letter of credit. The bank's letter of credit will expire in December 2008, unless extended or earlier terminated.

In conjunction with the Bonds, the Hospital purchased three separate interest swap rates (the "Swaps"), with a highly rated counterparty, having original notional amounts of \$4,000,000, \$5,000,000, and \$4,790,000. At December 31, 2007 and 2006, the swaps had notional amounts as follows:

	<u>2007</u> <u>Notional Amount</u>	<u>2006</u> <u>Notional Amount</u>	<u>Fixed</u> <u>Interest Rate</u>	<u>Maturity</u>
Swap A	\$ 2,940,000	\$ 3,215,000	3.45%	12/1/09
Swap B	5,000,000	5,000,000	3.82%	5/1/15
Swap C	<u>4,790,000</u>	<u>-0-</u>	3.99%	12/1/27
	<u>\$ 12,730,000</u>	<u>\$ 8,215,000</u>		

The change in fair market value of the Swaps is included as a component of investment income in nonoperating revenue (expenses). The fair value of the Swaps is reported as a long-term liability of \$770,680 and \$51,390 in the consolidated balance sheets at December 31, 2007 and 2006, respectively.

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Long-term debt activity for the years ended December 31, 2007 and 2006, was as follows:

	2007				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Revenue bonds, series 2002A	\$ 1,510,000	\$ -0-	\$ (50,000)	\$ 1,460,000	\$ 55,000
Revenue bonds, series 2002B	11,545,000	-0-	(275,000)	11,270,000	285,000
Floating rate demand notes	560,000	-0-	(130,000)	430,000	135,000
Bond discounts	(122,724)	-0-	6,894	(115,830)	(6,894)
Total long-term debt	\$ 13,492,276	\$ -0-	\$ (448,106)	\$ 13,044,170	\$ 468,106

	2006				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Revenue bonds, series 2002A	\$ 1,560,000	\$ -0-	\$ (50,000)	\$ 1,510,000	\$ 50,000
Revenue bonds, series 2002B	11,815,000	-0-	(270,000)	11,545,000	275,000
Floating rate demand notes	680,000	-0-	(120,000)	560,000	130,000
Bond refunding loss	(34,828)	-0-	34,828	-0-	-0-
Bond discounts	(129,619)	-0-	6,895	(122,724)	(6,895)
Total long-term debt	\$ 13,890,553	\$ -0-	\$ (398,277)	\$ 13,492,276	\$ 448,105

Debt service requirements on long-term debt at December 31, 2007, are as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 468,106	\$ 505,359
2009	483,106	489,358
2010	503,211	483,739
2011	524,369	463,674
2012	539,369	442,116
2013-2017	2,966,844	1,768,003
2018-2022	3,481,844	1,257,488
2023-2027	4,077,321	496,856
Total	\$ 13,044,170	\$ 5,906,593

Agreements relating to these long-term debt agreements and corresponding letters of credit contain various restrictive covenants, including covenants related to debt service coverage ratio, unrestricted liquidity position, and debt to tangible net assets ratio requirements.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

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13. INSURANCE BENEFIT PLAN

The Medical Center funds an executive insurance benefit plan for the Medical Center CEO. The plan accumulates cash value over time. The Medical Center records an asset and liability amount for the amount of premiums paid into the plan. The asset relating to the executive insurance benefit plan is reported in assets whose use is limited, net of amount required to meet current obligations on the consolidated balance sheets. The liability is reported as other long-term liabilities on the consolidated balance sheets.

14. NET PATIENT SERVICE REVENUE

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

- **Medicare**. The Medical Center is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Medical Center 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 Medical Center'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 Medical Center's classification of patients under the Medicare program and the appropriateness of their admissions are subject to an independent review by a peer review organization under contract with the Medical Center. As of December 31, 2007, the Medical Center's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2005. For the years ending December 31, 2007 and 2006, the Hospital reduced contractual allowances by \$75,000 and \$245,000, respectively, as a result of favorable changes for contractual settlements.

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- **Medicaid.** The Medical Center is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Medical Center 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. For the years ended December 31, 2007 and 2006, the Medical Center received and recorded in net patient service revenue \$2,505,527 and \$1,039,405, respectively, relating to net Medicaid Disproportionate Share Hospital (DSH) payments and Indiana Medicaid Municipal Hospital upper payment limit adjustments.

- **Other.** The Medical Center has also entered into preferred provider agreements with certain commercial insurance carriers. The basis for payment to the Medical Center under these agreements is a discount from established charges.

For the years ended December 31, 2007 and 2006, net patient service revenue was as follows:

	2007	2006
Gross patient service revenue		
Inpatient routine services	\$ 12,082,492	\$ 13,376,713
Inpatient ancillary services	22,679,295	22,789,912
Outpatient ancillary services	89,414,063	85,152,651
Total gross patient service revenue	124,175,850	121,319,276
Deductions from revenue		
Contractual allowances	64,077,227	59,490,564
Charity care	1,942,736	861,456
Bad debts	9,845,478	10,114,006
Total deductions from revenue	75,865,441	70,466,026
Total net patient service revenue	\$ 48,310,409	\$ 50,853,250

GASB requires bad debts to be reported as a deduction from gross patient service revenue while FASB requires bad debts to be reported as an operating expense.

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15. CHARITY CARE

The Medical Center 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 under its charity care policy. The following information measures the level of charity care provided for the years ended December 31, 2007 and 2006:

	2007	2006
Charges foregone, based on established rates	\$ 1,942,736	\$ 861,456

16. OTHER REVENUE

For the years ended December 31, 2007 and 2006, other revenue was comprised of the following:

	2007	2006
Cafeteria	\$ 114,824	\$ 132,432
Grant income	413,634	416,564
Miscellaneous	178,328	127,713
Total other revenue	\$ 706,786	\$ 676,709

17. NONOPERATING REVENUES (EXPENSES)

For the years ended December 31, 2007 and 2006, nonoperating revenues (expenses) were as follows:

	2007	2006
Nonoperating revenues (expenses)		
Investment income	\$ 922,452	\$ 1,061,320
Investment income - fair value change of interest rate swaps	(719,290)	(26,912)
Interest expense	(932,745)	(855,800)
Loss on disposal of capital assets	(857,298)	(15,151)
Other	(24,185)	51,963
Total nonoperating revenues (expenses)	\$ (1,611,066)	\$ 215,420

GASB requires interest expense to be reported as a nonoperating expense while FASB requires interest expense to be reported as an operating expense.

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18. 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 in the annual aggregate for hospitals with 100 or fewer beds and \$7,500,000 for hospitals with more than 100 beds. The Act also requires the Medical Center 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 Medical Center is insured against professional liability claims on a claims-made basis. Liabilities for incurred but not reported losses at December 31, 2007 and 2006, are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Medical Center's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the claims-made policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Medical Center intends to continue carrying such insurance. Professional liability insurance coverage is \$250,000 per occurrence and \$7,500,000 in the aggregate. In addition, the Medical Center has umbrella coverage of \$3,000,000 per occurrence and in the aggregate. Professional liability insurance expense for the years ended December 31, 2007 and 2006, was \$477,848 and \$450,486, respectively.

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19. CONCENTRATIONS OF CREDIT RISK

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

	<u>2007</u>	<u>2006</u>
Medicare	24 %	25 %
Medicaid	8	9
Blue Cross	10	8
Other third-party payors	23	21
Patients	<u>35</u>	<u>37</u>
	<u>100 %</u>	<u>100 %</u>

20. CONTINGENCIES

There are a variety of legal proceedings and claims by others against the Medical Center in a variety of matters arising out of the conduct of the Medical Center'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.

21. TRANSFERS

For the years ended December 31, 2007 and 2006, MHS received transfers from the Hospital totaling \$1,687,687 and \$1,688,955, respectively. MPS received transfers from the Hospital in the amount of \$1,206,561 and \$879,293, for the years ended December 31, 2007 and 2006, respectively. These transfers have been eliminated in consolidation.