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June 22, 2009

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

We have reviewed the audit report prepared by BKD, LLP, Independent Public Accountants, for the period January 1, 2008 to December 31, 2008. 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 Floyd Memorial Hospital and Health Services, as of December 31, 2008 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.

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STATE BOARD OF ACCOUNTS

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

Accountants' Report and Financial Statements

December 31, 2008 and 2007

BKD LLP
CPAs & Advisors

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
December 31, 2008 and 2007

Contents

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Independent Accountants' Report

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

We have audited the accompanying balance sheets of Floyd Memorial Hospital and Health Services (Hospital), a component unit of the Floyd County, Indiana, as of December 31, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Floyd Memorial Foundation, Inc. which is discretely presented in the financial statements and whose statements reflect total assets of $3,660,441 and $4,423,438 as of December 31, 2008 and 2007, respectively, and total revenues (deficit) of $(361,862) and $580,059 for the years then ended. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates the amounts included for Floyd Memorial Foundation, Inc., is based on the report of the other auditors.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis and pension information as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

BKD, LLP

April 23, 2009

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Management's Discussion and Analysis
Years Ended December 31, 2008 and 2007

Introduction

This management's discussion and analysis of the financial performance of Floyd Memorial Hospital and Health Services (Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2008 and 2007. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and investments increased by $20,706,405 or 37.7% in 2008 as compared to 2007 and by $13,393,998 or 32.3% in 2007 as compared to 2006
- The Hospital's net assets decreased in the past year by $12,080,727 or 11.1% as compared to 2007 when the Hospital's net assets increased by $3,204,295 or 3.0%
- The Hospital reported an operating gain in 2008 of $11,012,797 or 6.3% of total operating revenues and $6,491,371 or 4.2% of total operating revenues in 2007 and a loss of $8,791,465 or (6.2%) of total operating revenues in 2006.
- Net nonoperating revenues decreased by $19,890,702 in 2008 as compared to 2007 and $4,641,369 in 2007 as compared to 2006
- Days cash on hand increased to 185 in 2008 from 147 in 2007 and 111 in 2006
- Debt service coverage ratio improved to 4.1 in 2008 from 3.4 in 2007 and 0.9 in 2006

Using This Annual Report

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

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

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

The Hospital's total net assets—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

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

The Hospital's Net Assets

The Hospital's net assets are the difference between assets and liabilities reported in the balance sheet. The Hospital's net assets decreased by $12,080,727 or 11.1% in 2008 vs. 2007 and increased by $3,204,295 or 3.0% in 2007 over 2006, as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2008	2007	2006
Assets			
Patient accounts receivable, net	$ 19,349,926	$ 21,968,959	$ 21,834,628
Other current assets	48,806,334	27,345,922	16,298,608
Capital assets, net	129,032,856	130,771,270	133,544,336
Other noncurrent assets	44,579,860	56,261,994	58,518,614
Total assets	$ 241,768,976	$ 236,348,145	$ 230,196,186
Liabilities			
Long-term debt	$ 94,810,675	$ 98,093,190	$ 99,956,377
Other current and noncurrent liabilities	29,703,128	24,333,113	21,524,662
Fair value of interest rate swap	20,476,224	5,062,166	3,059,766
Total liabilities	144,990,027	127,488,469	124,540,805
Net Assets			
Invested in capital assets, net of related debt	31,892,639	38,060,772	41,368,751
Restricted expendable	3,013,565	10,089,432	13,884,551
Unrestricted	61,872,745	60,709,472	50,402,079
Total net assets	96,778,949	108,859,676	105,655,381
Total liabilities and net assets	$ 241,768,976	$ 236,348,145	$ 230,196,186

Other current assets increased significantly from 2007 to 2008, primarily driving the increase in hospital assets for the same period. This increase primarily consists of an increase in cash and cash equivalents in 2008 of $24,079,581 (134%) as compared to 2007. The cash increase is attributable to improved operations highlighted by an increase in net patient service revenue of $17,686,451 without a significant change in expenses in 2008 compared to 2007 and a reduction of days in accounts receivable in 2008 to 44 compared to 52 in 2007.

Operating Results and Changes in the Hospital's Net Assets

In 2008, the Hospital's net assets decreased by $12,080,727 or 11.1%, as shown in Table 2. This decrease is made up of several different components and represents a significant change when compared with the increase in net assets of $3,204,295 or 3.0% in 2007 and the decrease in net assets of $7,422,780 or 6.0% in 2006.

Table 2: Operating Results and Changes in Net Assets

	2008	2007	2006
Operating Revenues			
Net patient service revenue	$ 171,499,864	$ 153,813,413	$ 138,455,522
Other operating revenues	2,672,905	2,624,446	2,424,100
Total operating revenues	174,172,769	156,437,859	140,879,622
Operating Expenses			
Salaries and wages and employee benefits	83,819,553	75,678,968	77,560,864
Purchased services and professional fees	16,802,545	14,021,555	13,400,860
Depreciation and amortization	13,413,131	14,033,168	12,600,377
Other operating expenses	49,124,743	46,212,797	46,108,986
Total operating expenses	163,159,972	149,946,488	149,671,087
Operating Income (Loss)	11,012,797	6,491,371	(8,791,465)
Nonoperating Revenues (Expenses)			
Investment income	(2,774,068)	2,708,968	2,447,363
Interest rate swap (loss) gain	(15,414,058)	(2,002,400)	1,543,435
Noncapital grants and contributions	291,548	363,427	383,666
Interest expense	(5,594,526)	(4,283,495)	(2,694,901)
Other nonoperating revenues and expenses, net	285,576	(101,326)	(353,020)
Total nonoperating revenues (expenses)	(23,205,528)	(3,314,826)	1,326,543
Capital Grants			
Capital grants	112,004	27,750	42,142
Total capital grants	112,004	27,750	42,142
Change in Net Assets	$ (12,080,727)	$ 3,204,295	$ (7,422,780)

Operating Income (Loss)

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

The operating income for 2008 was $11,012,797 as compared to an operating income of $6,491,371 for 2007 and an operating loss of $8,791,465 for 2006. The primary components of change in operating results are:

- An increase in net patient service revenue of $17,686,451 or 11.5% in 2008 without a significant change in operating expenses as compared to an increase of $15,357,891 or 11.1% without a significant change in operating expenses in 2007
- An increase in salaries and benefits for the Hospital's employees of $8,140,648 or 10.8% in 2008 as compared to a decrease of $1,881,870 or 2.4% in 2007
- An increase in medical supply and drug costs of $754,021 or 2.0% in 2008 and $2,478,989 or 7.0% in 2007
- A decrease in depreciation and amortization of $620,037 or 4.4% in 2008 and an increase of $1,432,791 or 11.4% in 2007

Net patient service revenue increased by 11.5% due to an increase in patient days of 6.5% from 2007 to 2008 and a 6.3% charge increase. Net patient service revenue increased by 11.1% due to an increase in patient days of 8.6% from 2006 to 2007 and an 8.0% charge increase. The increase in revenue was also due to continued expansion of the Hospital's cardiovascular service line, including open-heart surgery in 2007. Revenues from most outpatient services increased by at least 9.9%, including cardiology, laboratory, imaging and home oxygen and medical equipment.

Full-time equivalent employees increased to 1,380 in 2008 or 4.86% from 1,316 in 2007 as compared to a decrease from 1,409 in 2006. The 2008 increase in staffing represented the funding of positions to support revenue cycle and supply chain initiatives and to improve nurse to patient ratios. The 2007 decrease was primarily due to the Hospital's diligent focus on productivity and proper staffing throughout the entire facility.

The rate of health care inflation has a direct effect on the cost of services provided by the Hospital. Expenditures for medical supplies and prescription drugs are a major component of the Hospital's costs. In 2008, the costs totaled $38,514,005 or 23.6% of total operating expenses, resulting in an increase of $754,021 or 2.0% over 2007. In 2007, the costs totaled $37,759,637 or 25.2% of total operating expenses, for an increase of $2,478,989 or 7.0% over 2006. In 2006, supplies and prescription drug costs totaled $35,280,648 or 23.6% of total operating expenses. Some of the major factors contributing to the increased medical supply and drug costs include an aging population, an increase in the complexity of patient cases, an increase in cardiac procedures, the introduction of new drugs that cannot be obtained in generic form, changes in therapeutic mix and pharmaceutical marketing. In 2008, the Hospital implemented a clinical quality value analysis (CQVA) program, focused on the quality and cost-effectiveness of supplies. The CQVA program yielded savings of $2,000,000 in 2008.

The Hospital also made significant progress in reducing cost per adjusted discharge between 2007 and 2008.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income and interest expense. The Hospital recorded investment losses of $4,700,000 in 2008 vs. a loss of $400,000 in 2007. Unrealized losses represented $5,000,000 of the total 2008 loss. The Hospital experienced losses of $15,414,058 and $2,002,400 in 2008 and 2007, respectively, related to the fair market value of its swap agreements associated with the 2003 Bond issues. Interest expense increased by $1,311,000 from 2007 to 2008 primarily due to failed remarketing of the 2003 Bonds.

The Hospital's Cash Flows

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

Capital Asset and Debt Administration

Capital Assets

At the end of 2008, the Hospital had $129,032,856 invested in capital assets, net of accumulated depreciation; this decrease of approximately $1.7 million from 2007 is primarily due to management of capital expenditures.

Debt

At December 31, 2008, the Hospital had $94,810,675 in revenue bonds and capital lease obligations outstanding. During 2008, the Hospital defeased the remaining balance of the 2003A Bonds of $34,175,000 and 2006 Bonds of $14,900,000 with proceeds from the issuance of the 2008 Bonds of $49,800,000.

Failed Bond Auction

The Hospital issued Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 2003A (2003A Bonds) and 2003B (2003B Bonds) as auction-rate securities. The 2003A Bonds and 2003B Bonds use a bond insurer for credit enhancement and liquidity support. Under the terms of the bond indentures, if for any reason the 2003A Bonds and 2003B Bonds do not remarket on any given remarketing date, the interest rate defaults to a maximum rate as calculated under the trust indentures which is 150% of the AA rated commercial paper rate. On February 2, 2008, and

March 18, 2008, the 2003A Bonds and 2003B Bonds, respectively, failed to remarket and defaulted to the rate noted above. In December 2008, the Hospital defeased the remaining balance of the 2003A Bonds and 2006 Bonds with proceeds from the issuance of the 2008 Bonds.

Other Operating Factors

Indiana Medicaid Disproportionate Share Hospital (DSH) Payment Program

The DSH program (which involves inter-governmental transfers with significant matching federal dollars) has experienced additional scrutiny from the Centers for Medicare and Medicaid Services (CMS, or commonly referred to as Medicare) and our nation's Congressional leaders, which creates challenges in estimating the level of expected payments from the Indiana Medicaid DSH program.

In May 2007, CMS issued a final ruling that may change the State of Indiana's ability to operate the DSH program as described above. Upon enactment of this final ruling, Congress issued a one-year moratorium on the ruling which was scheduled to expire in May 2008. In anticipation of the moratorium expiration, the state of Indiana accelerated payments through state fiscal year 2008.

Related to the May 2007 moratorium and various other governmental changes, management cannot reasonably estimate the state fiscal year 2009 Medicaid DSH payments. As such, no receivable at December 31, 2008, was recognized.

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

Contacting the Hospital's Financial Management

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

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Balance Sheets
December 31, 2008 and 2007

Assets

	2008	2007
Current Assets		
Cash and cash equivalents	$ 42,022,183	$ 17,942,602
Restricted investments - current	1,112,062	1,033,604
Patient accounts receivable, net of allowance; 2008 - $14,485,277, 2007 - $13,151,644	19,349,926	21,968,959
Estimated amounts due from third-party payers	-	2,247,063
Supplies	2,650,125	2,680,593
Prepaid expenses and other current assets	3,021,964	3,442,060
Total current assets	68,156,260	49,314,881
Noncurrent Cash and Investments		
Internally designated	33,566,863	36,940,039
Held by trustee for debt service	3,131,817	10,089,432
	36,698,680	47,029,471
Less amount required to meet current obligations	1,112,062	1,033,604
	35,586,618	45,995,867
Capital Assets, Net	129,032,856	130,771,270
Other Assets		
Other	8,993,242	10,266,127
Total assets	$ 241,768,976	$ 236,348,145

See Notes to Financial Statements

Liabilities and Net Assets

	2008	2007
Current Liabilities		
Current maturities of long-term debt	$ 2,329,542	$ 1,928,662
Payable to suppliers and contractors	6,280,092	6,946,418
Payable to employees (including payroll taxes and benefits)	8,531,256	6,792,853
Estimated amounts due to third-party payers	732,602	-
Accrued expenses	2,468,281	1,902,573
Due to Floyd Memorial Foundation, Inc.	5,434	15,304
Total current liabilities	20,347,207	17,585,810
Fair Value of Interest Rate Swap Agreements	20,476,224	5,062,166
Long-term Debt	94,810,675	98,093,190
Accrued Pension and Other Long-term Liabilities	9,355,921	6,747,303
Total liabilities	144,990,027	127,488,469
Net Assets		
Invested in capital assets, net of related debt	31,892,639	38,060,772
Restricted-expendable for		
Debt service	3,013,565	2,778,078
Capital acquisitions	-	7,311,354
Unrestricted	61,872,745	60,709,472
Total net assets	96,778,949	108,859,676
Total liabilities and net assets	$ 241,768,976	$ 236,348,145

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Floyd Memorial Foundation, Inc.
Statements of Financial Position
December 31, 2008 and 2007

Assets

	2008	2007
Current Assets		
Cash and cash equivalents	$ 528,372	$ 369,468
Pledges receivable, current portion	48,880	44,637
Interest receivable	12,006	14,141
Total current assets	589,258	428,246
Investments	2,891,103	3,875,272
Other Assets		
Pledges receivable, net of current portion	97,542	42,962
Cash surrender value of life insurance	82,508	76,958
	180,050	119,920
Total assets	$ 3,660,411	$ 4,423,438

Liabilities and Net Assets

	2008	2007
Current Liabilities		
Grant payable	$ 220,833	$ -
Total current liabilities	220,833	-
Net Assets		
Unrestricted	2,951,874	3,814,488
Temporarily restricted	476,534	597,780
Permanantly restricted	11,170	11,170
Total net assets	3,439,578	4,423,438
Total liabilities and net assets	$ 3,660,411	$ 4,423,438

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2008 and 2007

	2008	2007
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2008 - $21,720,714 , 2007 - $14,169,566	$ 171,499,864	$ 153,813,413
Other	2,672,905	2,624,446
Total operating revenues	174,172,769	156,437,859
Operating Expenses		
Salaries and benefits	83,819,553	75,678,968
Purchased services and professional fees	16,802,545	14,021,555
Supplies	38,514,005	37,759,637
Other expenses	10,624,501	8,598,091
Depreciation and amortization	13,413,131	14,033,168
Gain on sale of property and equipment	(13,763)	(144,931)
Total operating expenses	163,159,972	149,946,488
Operating Income	11,012,797	6,491,371
Nonoperating Revenues (Expenses)		
Investment income (loss)	(2,774,068)	2,708,968
Interest rate swap loss	(15,414,058)	(2,002,400)
Interest expense	(5,594,526)	(4,283,495)
Noncapital grants and contributions	291,548	363,427
Gain (loss) on investment in equity investee	285,576	(191,769)
Other	-	90,443
Total nonoperating expenses	(23,205,528)	(3,314,826)
Excess (Deficiency) of Revenues Over Expenses Before Capital Grants	(12,192,731)	3,176,545
Capital Grants	112,004	27,750
Increase (Decrease) in Net Assets	(12,080,727)	3,204,295
Net Assets, Beginning of Year	108,859,676	105,655,381
Net Assets, End of Year	$ 96,778,949	$ 108,859,676

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Floyd Memorial Foundation, Inc.
Statements of Activities
Years Ended December 31, 2008 and 2007

	2008	2007
Unrestricted Revenues		
Contributions	$ 41,904	$ 77,449
Golf outing	317,295	-
Investment return	(959,878)	347,907
Planned giving	5,550	803
Gain on sale of property	-	25,509
Net assets released from restrictions	233,447	128,391
Total unrestricted revenues	(361,682)	580,059
Expenses		
Grants	321,909	90,564
Fundraising - golf outing	115,462	94,763
Fundraising - other	488	545
General and administrative	63,073	48,660
Total expenses	500,932	234,532
Change in Unrestricted Net Assets	(862,614)	345,527
Temporarily Restricted Net Assets		
Contributions	112,201	22,205
Golf outing	-	293,982
Net assets released from restrictions	(233,447)	(128,391)
Change in Temporarily Restricted Net Assets	(121,246)	187,796
Change in Net Assets	$ (983,860)	$ 533,323
Unrestricted Net Assets		
Beginning of the year	$ 3,814,488	$ 3,468,961
Change in net assets	(862,614)	345,527
End of year	$ 2,951,874	$ 3,814,488
Temporarily Restricted Net Assets		
Beginning of the year	$ 597,780	$ 409,984
Change in net assets	(121,246)	187,796
End of year	$ 476,534	$ 597,780
Permanently Restricted Net Assets		
Beginning of year	$ 11,170	$ 11,170
End of year	$ 11,170	$ 11,170

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Statements of Cash Flows
Years Ended December 31, 2008 and 2007

	2008	2007
Operating Activities		
Receipts from and on behalf of patients	$ 177,098,562	$ 155,862,615
Payments to suppliers and contractors	(63,171,931)	(59,177,798)
Payments to employees	(78,344,206)	(73,280,650)
Other receipts, net	2,672,840	2,624,446
Net cash provided by operating activities	38,255,265	26,028,613
Noncapital Financing Activities		
Noncapital grants and contributions	291,548	453,870
Net cash provided by noncapital financing activities	291,548	453,870
Capital and Related Financing Activities		
Capital grants and contributions	112,004	27,750
Interest payments on long-term obligations	(5,778,797)	(4,214,035)
Principal paid on long-term debt and capital leases	(1,933,544)	(1,824,873)
Refinancing of long-term debt	(50,918,515)	-
Purchase of capital assets	(13,618,253)	(11,132,697)
Proceeds from issuance of long-term debt	49,800,000	-
Principal paid on promissory note	-	(2,380,000)
Net cash used in capital and related financing activities	(22,337,105)	(19,523,855)
Investing Activities		
Proceeds from disposition of investments	26,571,038	9,392,704
Purchase of investments	(20,890,398)	(6,028,473)
Interest and dividends on investments	1,876,083	1,708,588
Investment in equity investees	285,576	(191,769)
Distributions to equity investees	-	(55,200)
Proceeds from sale of assets	27,574	178,252
Net cash provided by investing activities	7,869,873	5,004,102
Increase in Cash and Cash Equivalents	24,079,581	11,962,730
Cash and Cash Equivalents, Beginning of Year	17,942,602	5,979,872
Cash and Cash Equivalents, End of Year	$ 42,022,183	$ 17,942,602

	2008	2007
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by Operating Activities		
Operating income	$ 11,012,797	$ 6,491,371
Depreciation and amortization	13,413,131	14,033,168
Provision for uncollectible accounts	21,720,714	14,169,566
Gain on disposition of assets	(13,763)	(144,931)
Changes in operating assets and liabilities		
Patient accounts receivable	(19,101,681)	(14,303,897)
Estimated amounts due from and to third-party payers	2,979,665	2,183,533
Accounts payable and accrued expenses	6,665,423	5,064,421
Prepaid assets, supplies and other assets	1,578,979	(1,464,618)
Net cash provided by operating activities	$ 38,255,265	$ 26,028,613
Supplemental Cash Flows Information		
Property, plant and equipment additions in accounts payable	$ -	$ 2,090,451
Deferred loss on defeasance of bonds	$ 1,843,515	$ -

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

Nature of Operations and Reporting Entity

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

Basis of Accounting and Presentation

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

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

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2008 and 2007, cash equivalents consisted primarily of repurchase agreements and money market accounts.

Risk Management

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

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

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition. The investment in equity investee is reported on the equity method of accounting. All other investments are carried at fair value. Fair value is determined using quoted market prices.

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

Patient Accounts Receivable

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

Supplies

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

Capital Assets

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

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

The Hospital capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. Total interest capitalized and incurred at December 31 was:

	2008	2007
Total interest expense incurred on borrowings for project	$ 382,292	$ 443,095
Interest income from investment of proceeds of borrowings for project	83,555	399,290
Net interest cost capitalized	$ 298,737	$ 43,805
Interest capitalized	$ 298,737	$ 43,805
Interest charged to expense	5,594,526	4,283,495
Total interest incurred	$ 5,893,263	$ 4,327,300

Other Assets

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

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

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

Other Long-term Liabilities

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

Interest Rate Swap Agreements

The Hospital uses interest rate swap agreements to manage financial risks related to interest rate movements and the effects on its cash flows. The Hospital has not designated the interest rate swap agreement as a hedging instrument under the provision of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. As a result, the agreement is recorded at its fair value in the balance sheet. The net cash payments or receipts under the interest rate swap agreements are recorded as an increase or decrease to interest expense.

Compensated Absences

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

Net Assets

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

Net Patient Service Revenue

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

Charity Care

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

Income Taxes

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

Floyd Memorial Foundation, Inc.

Floyd Memorial Foundation, Inc. (Foundation) is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs. The board of the Foundation is self-perpetuating.

Although the Hospital does not control the timing or amount of receipts from the Foundation, the majority of the Foundation's resources and related income are restricted by donors for the benefit of the Hospital. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the Hospital, the Foundation is considered a component unit of the Hospital and is discretely presented in the Hospital's financial statements.

During the years ended December 31, 2008 and 2007, the Foundation provided $257,850 and $85,375 respectively, of support to the Hospital. Complete financial statements of the Foundation may be obtained from its administrative office at the following address: 1850 State Street, New Albany, Indiana.

The Foundation is a private nonprofit organization that reports under FASB standards, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation's statements in the Hospital's financial reporting entity for these differences.

Note 2: Net Patient Service Revenue

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

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

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

The Hospital qualifies as a Medicaid disproportionate share hospital (DSH) provider under Indiana Law (HEA 1095, Public Law 27-1992) and, as such, is eligible to receive DSH payments. The amounts of these additional DSH funds are dependent on regulatory approval by agencies of the federal and state governments and is determined by level, extent and cost of uncompensated care (as defined) and various other factors. DSH payments have been made by the state of Indiana and the Hospital records such amounts as revenue when reasonably determined that the funds will be received. The Hospital recognized approximately $5,484,432 and $3,824,083 of net patient service revenue related to the DSH program for the years ended December 31, 2008 and 2007. The Hospital recognized receivables from this program in the amount of $0 and $2,042,842 at December 31, 2008 and 2007, respectively, for various Indiana state fiscal years, which ends June 30 each year.

In May of 2007, CMS issued a final ruling that may change the state of Indiana's ability to operate the DSH program as described above. Upon enactment of this final ruling, Congress issued a one year moratorium on the ruling, which was scheduled to expire in May 2008. In anticipation of the moratorium expiration, the state of Indiana accelerated payments through state fiscal year 2008. A condition of the accelerated payments may result in a payback of the DSH funds. As such, it is reasonably possible estimates associated with the DSH program could change materially in the near term.

Related to the May 2007 moratorium and various other governmental changes, management cannot reasonably estimate the state fiscal year 2009 Medicaid DSH payments. As such, no receivable at December 31, 2008, was recognized.

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

Approximately 54% and 44% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2008 and 2007, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Note 3: Deposits, Investments and Investment Income

Deposits

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

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

Investments

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

At December 31, 2008, the Hospital had the following investments and maturities:

Type	Fair Value	Maturities in Years: Less Than 1	1 to 5	6 to 10	More Than 10
Repurchase agreements	$ 2,874,000	$ 2,874,000	$ -	$ -	$ -
U.S. agencies obligations	1,133,845	553,752	491,486	-	88,607
Money market mutual funds	5,392,941	5,392,941	-	-	-
Mutual funds	30,114,798	30,114,798	-	-	-
	$ 39,515,584	$ 38,935,491	$ 491,486	$ -	$ 88,607

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

Credit Risk – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in corporate bonds to the top two ratings issued by nationally recognized statistical rating organizations (NRSROs). At December 31, 2008 and 2007, the Hospital's investments in U.S. agencies obligations not directly guaranteed by the U.S. Government were rated Aaa by Moody's Investor Services.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the underlying securities for the Hospital's investments in repurchase agreements at December 31, 2008, are held by the counterparties in other than the Hospital's name. The Hospital's investment policy does not address how securities underlying repurchase agreements are to be held.

Concentration of Credit Risk – The Hospital places no limit on the amount that may be invested in any one issuer. At December 31, 2008 and 2007, the Hospital had no investments in corporate bonds.

Summary of Carrying Values

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

	2008	2007
Carrying value		
Deposits	$ 39,205,279	$ 3,428,228
Investments	39,515,584	61,543,845
	$ 78,720,863	$ 64,972,073

Included in the following balance sheet captions:

	2008	2007
Cash and cash equivalents	$ 42,022,183	$ 17,942,602
Restricted investments - current	1,112,062	1,033,604
Noncurrent cash and investments	35,586,618	45,995,867
	$ 78,720,863	$ 64,972,073

Investment Income (Loss)

Investment income for the years ended December 31 consisted of:

	2008	2007
Interest and dividend income	$ 1,876,083	$ 1,708,588
Net increase (decrease) in fair value of investments	(4,650,151)	1,000,380
	$ (2,774,068)	$ 2,708,968

Note 4: Patient Accounts Receivable

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

	2008	2007
Medicare	$ 7,036,232	$ 9,039,567
Medicaid	1,854,133	2,623,867
Other third-party payers	9,206,648	10,518,078
Patients	15,738,190	12,939,091
	33,835,203	35,120,603
Less allowance for uncollectible accounts	14,485,277	13,151,644
	$ 19,349,926	$ 21,968,959

Note 5: Investments in Uncombined Entities

The investments in uncombined entities are accounted for on the equity method. The equity earnings of the uncombined entities are accounted for on the equity method and are in included in nonoperating revenues. Investments in uncombined entities consist of a 33.33% interest in Southern Indiana Rehabilitation Hospital (an acute rehabilitation hospital), a 48% interest in Kleinert, Kutz Associates Surgery Center, LLC, d/b/a Northgate Surgery Center, LLC (an outpatient surgery center), an 11% interest in Indiana Healthcare Reciprocal Risk Retention Group (Risk Retention Group) (a medical malpractice insurance captive), a 100% interest in Southern Indiana Health Care Alliance, LLC (an organization that furthers the charitable and health care mission of its members), a 50% interest in Harrison-Floyd Health Services, LLC (an outpatient center providing urgent treatment services and occupational medicine) and a 50% interest in Northgate Medical Imaging, LLC, d/b/a Priority Imaging (an outpatient diagnostic imaging center).

Note 6: Capital Assets

Capital assets activity for the years ended December 31 were:

	2008				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 7,820,099	$ -	$ -	$ -	$ 7,820,099
Land improvements	3,424,160	89,654	-	-	3,513,814
Buildings and leasehold improvements	119,275,740	430,317	(171,228)	10,873,611	130,408,440
Equipment	110,402,384	6,145,094	(22,574)	-	116,524,904
Construction in progress	5,951,490	4,922,868	-	(10,873,611)	747
	246,873,873	11,587,933	(193,802)	-	258,268,004
Less accumulated depreciation					
Land improvements	2,480,733	134,310	-	-	2,615,043
Buildings and leasehold improvements	37,288,076	3,891,801	(119,860)	-	41,060,017
Equipment	76,333,794	9,226,294	-	-	85,560,088
Total accumulated depreciation	116,102,603	13,252,405	(119,860)	-	129,235,148
Capital assets, net	$ 130,771,270	$ (1,664,472)	$ (73,942)	$ -	$ 129,032,856

	2007				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 7,820,099	$ -	$ -	$ -	$ 7,820,099
Land improvements	4,127,807	68,357	(772,004)	-	3,424,160
Buildings and leasehold improvements	123,998,727	248,708	(5,250,947)	279,252	119,275,740
Equipment	122,331,768	5,153,165	(17,082,549)	-	110,402,384
Construction in progress	547,539	5,683,203	-	(279,252)	5,951,490
	258,825,940	11,153,433	(23,105,500)	-	246,873,873

	2007				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Less accumulated depreciation					
Land improvements	$ 3,113,785	$ 138,953	$ (772,005)	$ -	$ 2,480,733
Buildings and leasehold improvements	38,936,559	3,602,465	(5,250,948)	-	37,288,076
Equipment	83,231,260	10,131,024	(17,028,490)	-	76,333,794
Total accumulated depreciation	125,281,604	13,872,442	(23,051,443)	-	116,102,603
Capital assets, net	$ 133,544,336	$ (2,719,009)	$ (54,057)	$ -	$ 130,771,270

Note 7: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance from Risk Retention Group under a claims-made policy. The Hospital pays an annual premium to Risk Retention Group for its torts insurance coverage. The Risk Retention Group's governing agreement specifies that the Risk Retention Group will be self-sustaining through member premiums and will re-insure through commercial carriers for claims in excess of stop-loss amounts. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no liabilities were recorded at December 31, 2008 and 2007. It is possible that this estimate could change materially in the near term.

Prior to January 1, 2006, the Hospital was insured for medical malpractice claims through a claims-made policy with the Reciprocal of America (ROA), formally the Virginia Insurance Reciprocal. As a result of ROA going into receivership, the Hospital has effectively become self insured for claims prior to this date. As of December 31, 2008 and 2007, the Hospital accrued a liability of $24,230 and $85,000, respectively, relating to these claims. It is possible that this estimate could change materially in the near term.

Note 8: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self insured for health claims of participating employees and dependents up to an annual aggregate amount of $90,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is possible that the Hospital's estimate will change by a material amount in the near term.

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

	2008	2007
Balance, beginning of year	$ 813,390	$ 874,976
Current year claims incurred and changes in estimates for claims incurred in prior years	5,777,164	5,564,623
Claims and expenses paid	(5,779,591)	(5,626,209)
Balance, end of year	$ 810,963	$ 813,390

Note 9: Long-term Obligations

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

	2008				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds Payable - Series 1998	$ 16,080,000	$ -	$ 735,000	$ 15,345,000	$ 775,000
Revenue Bonds Payable - Series 2003	69,050,000	-	34,875,000	34,175,000	475,000
Revenue Bonds Payable - Series 2006	15,000,000	-	15,000,000	-	-
Revenue Bonds Payable - Series 2008	-	49,800,000	-	49,800,000	655,000
Capital lease obligations	1,406,276	-	398,544	1,007,732	424,542
	101,536,276	49,800,000	51,008,544	100,327,732	2,329,542
Less					
Unamortized bond discount	229,614	-	16,256	213,358	-
Deferred amount on refunding	1,284,810	1,843,515	154,168	2,974,157	-
Total long-term debt obligations	$ 100,021,852	$ 47,956,485	$ 50,838,120	$ 97,140,217	$ 2,329,542

	2007				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds Payable - Series 1998	$ 16,780,000	$ -	$ 700,000	$ 16,080,000	$ 735,000
Revenue Bonds Payable - Series 2003	69,800,000	-	750,000	69,050,000	700,000
Revenue Bonds Payable - Series 2006	15,000,000	-	-	15,000,000	100,000
Capital lease obligations	1,781,149	-	374,873	1,406,276	393,662
	103,361,149	-	1,824,873	101,536,276	1,928,662

	2007				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Less					
Unamortized bond discount	$ 245,870	$ -	$ 16,256	$ 229,614	$ -
Deferred amount on refunding	1,371,212	-	86,402	1,284,810	-
Total long-term debt obligations	$ 101,744,067	$ -	$ 1,722,215	$ 100,021,852	$ 1,928,662

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

	2008				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Accrued pension liabilities	$ 6,131,302	$ 3,002,581	$ -	$ 9,133,883	$ -
Other long-term liabilities	867,008	-	197,669	669,339	447,301
Total other long-term obligations	$ 6,998,310	$ 3,002,581	$ 197,669	$ 9,803,222	$ 447,301

	2007				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Accrued pension liabilities	$ 4,220,434	$ 1,910,868	$ -	$ 6,131,302	$ -
Other long-term liabilities	39,246	827,762	-	867,008	251,007
Total other long-term obligations	$ 4,259,680	$ 2,738,630	$ -	$ 6,998,310	$ 251,007

Revenue Bonds Payable

The Hospital has revenue bonds payable with the Indiana Healthcare Facility Financing Authority (Authority). The Master Trust Indenture requires that certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service in the balance sheets. The Master Trust Indenture also places limits on the incurrence of additional borrowings and requires that certain measures of financial performance be maintained so long as the bonds are outstanding. At December 31, 2008, the Hospital was in compliance with such requirements.

Series 1998

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

Series 2003

In December 2003, the Hospital participated in the issuance of $72,925,000 Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 2003A (2003A Bonds) and 2003B (2003B Bonds). The 2003A Bonds and 2003B Bonds, which were issued as auction rate securities, bear interest at the auction rate, as determined by the results of an auction every 35 days under an agreement with The Bank of New York. The proceeds were used for the advance refunding of the Authority's Series 1997 and Series 2000 Bonds and to finance certain capital projects. The 2003B Bonds are subject to retirement in varying principal payments through 2034. The bonds are secured by the gross revenues of the Hospital. Payments of bond principal are also secured by an insurance policy issued by a commercial insurer.

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

Series 2006

In December 2006, the Hospital participated in the issuance of $15,000,000 Indiana Health and Educational Facility Financing Authority Adjustable Rate Hospital Revenue Bonds, Series 2006 (2006 Bonds). The 2006 Bonds were issued as auction rate securities and bear interest at the auction rate. The proceeds were used to finance certain capital projects. The 2006 Bonds are subject to retirement in varying principal payments through 2036. The bonds are secured by the gross revenues of the Hospital. Payments of bond principal and interest are also secured by a letter of credit in the amount of $15,187,500 expiring on December 16, 2011, issued by a financial institution.

In December 2008, the Hospital defeased the remaining balance of the 2006 Bonds with proceeds from the issuance of the 2008 Bonds.

Series 2008

In December 2008, the Hospital participated in the issuance of $49,800,000 Indiana Health and Educational Facility Financing Authority Adjustable Rate Hospital Revenue Bonds, Series 2008 (2008 Bonds). The 2008 Bonds were issued as variable rate demand bonds under an agreement with Piper Jaffray & Co. The interest rate was 1.35% at December 31, 2008. The proceeds were used to refinance the Series 2003A and Series 2006 Bonds. The 2008 Bonds are subject to retirement in varying principal payments through 2036. The bonds are secured by the gross revenues of the Hospital. Payments of bond principal and interest are also secured by a letter of credit in the amount of $50,373,047 expiring on December 5, 2013, issued by a financial institution. In the event of a tender advance on the letter of credit, repayment terms consist of interest only payments of the first 367 days with payment of principal and interest thereafter based on an amortization period extending through 24 months or the stated expiration of the agreement.

Capital Lease Obligations

The Hospital is obligated under leases for certain medical equipment that are accounted for as capital leases. The lease agreements bear interest at various amounts up to 8.78%. Assets under capital leases at December 31, 2008, totaled $1,011,563, net of accumulated depreciation of $1,011,564 and at December 31, 2007, totaled $1,416,189, net of accumulated depreciation of $606,938.

The debt service requirements for long-term obligations as of December 31, 2008, were as follows:

Years Ending December 31	Total to be Paid	Principal	Interest
2009	$ 4,484,537	$ 2,329,542	$ 2,154,995
2010	4,616,520	2,548,270	2,068,250
2011	4,312,834	2,329,920	1,982,914
2012	4,193,791	2,280,000	1,913,791
2013	4,252,502	2,410,000	1,842,502
2014-2019	23,984,572	14,895,000	9,089,572
2020-2025	26,880,838	20,655,000	6,225,838
2026-2031	25,359,039	22,270,000	3,089,039
2032-2036	31,297,709	30,610,000	687,709
	$ 129,382,342	$ 100,327,732	$ 29,054,610

Note 10: Line of Credit

The Hospital has an unsecured open-ended demand line of credit in the amount of $10,000,000 with a bank. At the Hospital's option, amounts outstanding under the line of credit bear interest at the 30-Day London Interbank Offering Rate (LIBOR rate), plus 1.25% adjusted monthly. There were no borrowings on the line of credit at December 31, 2008 and 2007.

Note 11: Interest Rate Swap Agreements

Objective of the Interest Rate Swap Agreements

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

Terms

Under the interest rate swap agreements associated with each of the 2003A Bonds and 2003B Bonds, the Hospital receives interest from the counterparty at 70.00% of the one-month LIBOR and pays interest to the counterparty at a fixed rate of 4.05% on notional amounts totaling $67,600,000 at December 31, 2008 and 2007. Of that, $33,800,000 is related to the 2003A Bonds and 2003B Bonds each. While the 2003A Bonds were defeased in December 2008, the related swap agreement remains in place. The interest rate swap agreements may be terminated by the Hospital upon five days written notice to the counterparty. The agreements were entered into on November 10, 2003, and are scheduled to expire on March 1, 2034, and required no initial net cash receipt or payment by the Hospital. Beginning in 2009, the notional amount of the swap agreements decline by a corresponding amount each time a principal payment was originally scheduled to become due on the associated debt until the notional amounts for each agreement reach $2,650,000 at the termination of the swap agreements. Under the agreements, the Hospital pays or receives the net interest amount monthly with the settlements included in interest expense.

Fair Value

As of December 31, 2008 and 2007, the agreements had fair values of $(20,476,224) and $(5,062,166), respectively. The fair value of the agreement is recognized in the Hospital's balance sheets in long-term liabilities.

Interest Rate Risk

As a means of limiting its exposure to fair value losses occurring from rising variable interest rates associated with the interest rate swap agreements. Beginning in 2009, the notional amount of the swap agreements declines by a corresponding amount each time a principal payment becomes due on the associated debt until the notional amounts for each agreement reach $2,650,000 at the termination of the swap agreements. The termination date of the swap agreements corresponds to the maturity of the 2003A Bonds and 2003B Bonds. At December 31, 2008, the notional amount of the interest rate swap agreements will decline as follows:

Maturities in Years			
Less Than 1	1-5	6-10	More Than 10
$ 175,000	$ 5,325,000	$ 6,625,000	$ 55,475,000

Credit Risk

The swap's fair value represented the Hospital's credit exposure to the counterparty should the counterparty to this transaction fail to perform according to the terms of the swap agreement, the Hospital has a maximum possible loss equivalent to the swap's fair value at that date. As of December 31, 2008, the Hospital was not exposed to credit risk because the swap had a negative fair value. The swap counterparty was rated A2 by Fitch Ratings, A by Standard & Poor's and A by Moody's Investors Service as of December 31, 2008. The interest rate swap agreements do not contain collateral provisions for either party.

Basis Risk

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

Termination Risk

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

Note 12: Operating Leases

The Hospital has entered into various operating leases for office space and medical equipment expiring at various years through 2016. Rent expense was $1,836,059 and $1,908,950 for the years ended December 31, 2008 and 2007, respectively.

Future minimum lease payments at December 31, 2008, are:

2009	$ 1,845,344
2010	1,703,310
2011	1,597,491
2012	1,922,042
2013	1,369,492
2014-2018	5,282,146
Future minimum lease payments	$ 13,719,825

Note 13: Defined Benefit Pension Plan

Plan Description

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

Funding Policy

The authority to establish and amend obligations of plan members is established by the written agreement between the Hospital's board of trustees and the plan administrator. Plan members are required to contribute 0% of their annual covered salary. The Hospital is required to contribute at an actuarially determined rate; the current rate is 0% of annual covered payroll.

Annual Pension Cost and Net Pension Obligation

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

	2008	2007
Annual required contribution	$ 3,233,000	$ 2,409,321
Interest on net pension obligation	507,074	337,635
Adjustment to annual required contribution	(944,612)	(628,969)
Annual pension cost	2,795,462	2,117,987
Contributions made	-	-
Increase in net pension obligation	2,795,462	2,117,987
Net pension obligation at beginning of the year	6,338,421	4,220,434
Net pension obligation at end of the year	$ 9,133,883	$ 6,338,421

Funded Status and Funding Progress

As of May 1, 2007, the most recent actuarial valuation date, the plan was 96.6% funded. The actuarial accrued liability for benefits was $39,221,937 and the actuarial value of assets was $37,882,873 resulting in an unfunded actuarial accrued liability (UAAL) of $1,339,064. The covered payroll (annual payroll of active employees covered by the plan) was $50,864,858 and the ratio of the UAAL to the covered payroll was 2.6%.

As of December 31, 2008, the fair value of the pension trust fund assets had decreased to $27,530,190.

Actuarial Methods and Assumptions

The annual required contribution for 2008 was determined as part of an actuarial valuation on May 1, 2007, using the projected unit credit actuarial cost method. The actuarial assumptions included (a) 8% investment rate of return (net of administrative expenses) and (b) 4% projected salary increases per year. The actuarial value of assets was determined using market value. The UAAL is being amortized on a level dollar basis over a 10-year period.

Three-year Trend Information

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2006	$ 1,688,280	0%	$ 4,220,434
December 31, 2007	$ 2,117,987	0%	$ 6,338,421
December 31, 2008	$ 2,795,462	0%	$ 9,133,883

Note 14: Defined Contribution Pension Plan

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by a board of trustees appointed by the County Commissioners of Floyd County, Indiana. The plan provides retirement benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Contributions made by plan members at December 31, 2008 and 2007, were $3,054,113 and $3,011,150, or 5% of total payroll for both years. Contributions made by the Hospital at December 31, 2008 and 2007, were $771,338 and $833,143, or 1% of total payroll for both years.

Note 15: Disclosures About Fair Value of Financial Instruments

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

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

Investments

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Investments in real estate are excluded from the disclosure because they are not financial instruments.

Long-term Debt

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

Interest Rate Swap Agreements

The fair value has been estimated by a third party.

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

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 42,022,183	$ 42,022,183	$ 17,942,602	$ 17,942,602
Investments	36,698,680	36,698,680	47,029,471	47,029,471
	$ 78,720,863	$ 78,720,863	$ 64,972,073	$ 64,972,073
Financial liabilities				
Long-term debt	$ 100,114,374	$ 100,384,707	$ 101,306,662	$ 101,600,601
Interest rate swap agreements	20,476,224	20,476,224	5,062,166	5,062,166
	$ 120,590,598	$ 120,860,931	$ 106,368,828	$ 106,662,767

Note 16: Significant Estimates and Concentrations

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

Allowance for Net Patient Service Revenue Adjustments

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

Malpractice Claims

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

Incurred, But Not Reported, Employee Health Insurance Claims

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

Litigation

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

Guarantee

The Hospital guarantees certain third-party capital leases of an unconsolidated affiliated organization. The guarantee terms are through the duration of the capital leases which expire through 2012. At December 31, 2008 and 2007, the Hospital has guaranteed 50% of the $3,520,094 and $4,877,530, respectively, outstanding capital leases of the affiliated organization.

Current Economic Conditions

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

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

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

Note 17: Floyd Memorial Foundation, Inc.

Financial Statements

The financial statements of the Foundation are presented in accordance with the provisions of Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made* and No. 117, *Financial Statements of Not-for-Profit Organizations*. Statement No. 116 requires the Foundation to distinguish between contributions that increase permanently restricted net assets, temporarily restricted net assets and unrestricted net assets. It also required recognition of contributions, including contributed services meeting certain criteria, at fair values. Statement No. 117 establishes standards for external financial statements of not-for-profit organizations and requires a statement of financial position, a statement of activities and a statement of cash flows. As permitted by GASB Statement No. 34, the Hospital has elected not to present a statement of cash flows for the Foundation in the basic financial statements of the Hospital's reporting entity.

Investments and Investment Return

Investments at December 31 consisted of the following:

	2008	2007
Cash and cash equivalents	$ 70,803	$ 111,172
Common stocks	936,860	1,577,109
Bonds	1,050,978	1,171,553
Equity mutual funds	832,462	1,015,438
	$ 2,891,103	$ 3,875,272

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

	2008	2007
Dividends and interest income	$ 140,937	$ 208,269
Realized gains (losses) on investments	(165,418)	100,987
Change in fair value of investments	(935,397)	38,651
	$ (959,878)	$ 347,907

Supplementary Information

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Schedule of Funding Progress
December 31, 2008 and 2007

Required Supplementary Information

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

(Dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets a	Actuarial Accrued Liability (AAL) - Entry Age b	Unfunded AAL (UAAL) b-a	Funded Ratio a/b	Covered Payroll c	UAAL as a Percentage of Covered Payroll (b-a)/c
December 31, 2005	$34,337	$33,206	($1,131)	103%	$40,412	(3%)
December 31, 2006	$36,464	$35,559	($905)	103%	$45,555	(2%)
December 31, 2007	$37,883	$39,222	$1,339	97%	$50,865	3%