

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

AUDIT REPORT
OF

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF
HARRISON COUNTY, INDIANA

January 1, 2008 to December 31, 2008



FILED
02/02/2010

TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Hospital Officials	2
Independent Auditor's Report	3
Management's Discussion and Analysis.....	4-15
Basic Financial Statements:	
Statement of Net Assets.....	16
Statement of Revenues, Expenses, and Changes in Net Assets	17
Statement of Cash Flows - Restricted and Unrestricted Funds	18
Notes to Financial Statements	19-33
Exit Conference.....	34

HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Chief Executive Officer	Steven L. Taylor	01-01-08 to 12-31-10
Chief Financial Officer	Jeffrey L. Davis	01-01-08 to 12-31-10
Chairman of the Hospital Board	Paul Martin	01-01-08 to 12-31-10
President of the Board of County Commissioners	James Goldman	01-01-08 to 12-31-10



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2769

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF THE HARRISON COUNTY HOSPITAL, HARRISON COUNTY, INDIANA

We have audited the accompanying basic financial statements of the Harrison County Hospital (Hospital), as of and for the year ended December 31, 2008, as listed in the Table of Contents. 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 audit. We did not audit the financial statements of the Harrison MOB, LLC, which represents 100% of the assets and revenues of the discretely presented component unit. Those financial statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Harrison MOB, LLC, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Hospital and its discretely presented component unit as of December 31, 2008, and the respective changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States.

The Management Discussion and Analysis, as listed in the Table of Contents, is not a required part of the basic financial statements but is 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.

STATE BOARD OF ACCOUNTS

January 21, 2010

HARRISON COUNTY HOSPITAL

Management Discussion and Analysis (MD&A)

This section of Harrison County Hospital's (HCH) annual financial statements presents background information and management discussion and analysis of the HCH financial performance for the year ended December 31, 2008. HCH reports results on a fiscal year of January 1 to December 31, and any reference to a year in this MD&A indicates the HCH fiscal years. This MD&A does not include a discussion and analysis of the activities and results of the Harrison County Hospital Foundation.

This MD&A should be read together with the financial statements and accompanying Notes to the Financial Statements included in this report.

Financial Highlights

- HCH net assets decreased by \$4,029,212 in 2008, resulting from operating gains of \$623,967, non-operating expenses of \$(533,350) (net), equity distributions from Harrison MOB, LLC (a discrete component unit) of \$235, and an extraordinary loss attributable to the disposal of the former hospital facility of \$(4,119,829).
- Total net patient revenue, net of provision for bad debt, increased by 14.2%, while operating expenses increased by 23.4%. Net operating income for the year was \$623,967 a decrease of 81.9% from 2007.
- Long term debt, including current maturities, is \$34,184,136. This amount consists of \$29,425,000 in revenue bonds payable for the new hospital construction, and \$4,759,136 payable that has been drawn on the medical office building construction loan. Principal payments on the medical office building loan will begin in March 2009.
- Effective December 15, 2005, HCH has operated as a Critical Access Hospital (CAH). The CAH program under Medicare was developed to assist smaller hospitals that service rural areas and areas of critical need, as it provides alternative reimbursement methods for patient services. Under the CAH program, Medicare will reimburse HCH at 101% of the allowable costs of providing services to Medicare patients.
- Construction was completed in February 2008 on the \$50 million replacement hospital facility. The funding was provided by: \$30 million in variable rate revenue bonds, backed by a five year renewable letter of credit commitment from J.P. Morgan Chase Bank, and issued through the Indiana Health and Educational Facility Finance Authority; a contribution from Harrison County of \$12 million, which was funded from the sharing of gaming tax revenue; a grant from the Harrison County Community Foundation of \$5 million; HCH cash reserves of \$3 million. The revenue bonds were sold in November of 2005. Following the sale of

the revenue bonds, HCH entered into an interest rate SWAP covering \$25 million of the \$30 million bond issue. The SWAP effectively fixes the interest rate at 3.81% for the life of those bonds. The grants were made in scheduled payments to HCH starting in 2005 and ending in 2007. Following is a general breakdown of the final project costs:

* Land	\$686,000
* Site Work and Building Construction	32,551,000
* Equipment (original plan)	9,300,000
* Equipment Added – MRI and CT Scan	2,284,000
* Architectural Design Fees	1,963,000
* Engineers, Consultants, Planners	1,313,000
* Bond Issuance Expenses	627,000
* Construction Period Interest	980,000
* Build-out for Tenant – Dialysis Ctr.	385,000
* Other	<u>281,000</u>
Total	<u>\$50,370,000</u>

HCH has been researching the feasibility of, and planning for a new facility for a number of years. The primary reasons for building the replacement hospital are:

1. To replace an ageing and outdated facility, dating to 1950
2. Increased patient volumes have created the need for more space
3. To enhance functional areas for patient services, patient access, equipment, building and safety codes
4. The cost to build a new replacement facility is favorable in comparison to renovating the old structure
5. Relocating to a new site will provide greater visibility, better access to major roads, and room for future expansion
6. To allow HCH to remain competitive in the development of medical staff and new services

The new facility was placed into service during February 2008.

- In July 2006 HCH entered into an agreement with several physicians and healthcare providers to establish Harrison MOB, LLC. This entity was formed to invest in and operate a new medical office building to be located on the campus of the new HCH facility. HCH invested \$1,155,000 and which includes ownership of approximately 55% of the shares of the LLC. As of December 31, 2008 total assets of the LLC were \$7,867,279, and the activity of the LLC is included in the Financial Statements as a discrete component unit. The LLC began construction on the medical office building in 2007, with construction substantially complete at the end of 2008. The construction costs, net of tenant build-out overages, totaled \$7,342,000, with \$5,440,000 being financed with a bank loan, and the hospital loaning the LLC an additional \$250,000. More financial information on the LLC and the bank note is included in the Notes to the Financial Statements.

- In April 2008 the Harrison County Commissioners and the Board of Trustees formed an agreement to construct an ambulance station on the hospital campus, which will replace the ambulance station on the vacated hospital campus. The building will be an asset of the hospital. The estimated total cost of the building is approximately \$1,000,000, with Harrison County contributing capital equaling 72% of the cost, up to a total of \$750,000, and HCH contributing the balance. Construction of the building is to begin in 2009.
- In May 2008 the Harrison County Commissioners and the Board of Trustees approved the transfer of certain HCH land and buildings to Harrison County. The property to be transferred consists of the land and improvements, hospital buildings and medical office buildings that were taken out of service with the move to the new campus. The transfer took place on July 30, 2008. The properties carry an original cost of \$14,022,099, and had on July 30, 2008, total accumulated depreciation of \$10,367,222, leaving a book value of \$3,654,877. The resulting loss on disposal of the properties has been treated as an extraordinary item in the 2008 financial statements. The decision to transfer the property rather than selling it on the open market was based on the following factors:
 1. The property has limited resale potential in the Harrison County market and is expensive to maintain as a property for sale
 2. Harrison County is an affiliated governmental unit and has a current shortage of space for county offices
 3. Harrison County supported the construction of the new hospital facility with a sizeable contribution of capital
 4. The transfer to the County will promote the long term utilization and maintenance of the property, which is a benefit to the community
- HCH continues to implement an upgraded and expanded hospital information system. Current projects include the implementation of electronic medical records systems, which will capture and store patient medical records in an electronic format. This is a significant investment in technology which improves quality of information for clinical and financial management, which in turn will facilitate improved quality of care. The enhanced information systems will also allow for operational efficiencies as patient volumes increase, and will be vital in conforming to regulatory requirements which continue to expand in number and complexity.

The Financial Statements

The HCH financial statements consist of - a Statement of Net Assets, a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These statements provide short-term and long-term financial information.

The Statement of Net Assets and Statement of Revenues, Expenses, and Changes in Net Assets provide information on the HCH resources and its activities. These two statements report the net assets of HCH and its changes. Increases or decreases of the HCH net assets are one indicator of whether its financial health is improving or eroding. However, other non-financial factors such as changes in economic conditions, population growth, patient demographic changes, and new or changed government legislation should also be considered.

The Statement of Net Assets includes all of the HCH assets and liabilities, and the net assets, which can be thought of as the net worth of HCH. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the financial results of the HCH operations and presents revenue earned and expenses incurred. The other primary financial statement is the Statement of Cash Flows. This statement provides information about HCH sources and uses of cash during the year, and the cash flows from operating activities, capital and related financing activities, and investing activities.

A summary of the HCH Consolidated Statement of Net Assets as of December 31, 2008 and 2007 is presented below, in 000's.

	2008	2007	\$ Change	% Change
Assets:				
Cash and Investments	\$14,141	\$10,263	\$3,878	37.8%
Capital Assets	57,679	53,290	4,389	8.2%
Other Assets	13,491	10,519	2,972	28.3%
Restricted Assets - Cash	6,848	16,345	(9,497)	-58.1%
Restricted Assets - Receivable	0	0	0	N/A
Total Assets	<u>\$92,159</u>	<u>\$90,417</u>	<u>\$1,742</u>	1.9%
Liabilities:				
Long Term Debt Outstanding	\$33,516	\$29,448	\$4,068	13.8%
Current and Other Liabilities	8,250	6,446	1,804	28.0%
Total Liabilities	<u>41,766</u>	<u>35,894</u>	<u>5,872</u>	16.4%
Net Assets:				
Invested in Capital Assets - Net of Related Debt	22,725	22,855	(130)	-0.6%
Unrestricted	27,644	31,522	(3,878)	-12.3%
Restricted	24	146	(122)	-83.6%
Total Net Assets	<u>50,393</u>	<u>54,523</u>	<u>(4,130)</u>	-7.6%
Total Liabilities and Net Assets	<u>\$92,159</u>	<u>\$90,417</u>	<u>\$1,742</u>	1.9%

The decrease in restricted cash and the increase in capital assets is the result of the use of cash for the hospital construction project. The increase in cash and investments is the result of positive cash flow generated from operations (\$1.8 million) and the reimbursement of prior year project expenditures from restricted construction project funds (\$2.2 million). Collections and reimbursements for patient services provided the primary source of cash from operations.

Capital Assets have increased due to the completion of the new \$50 million hospital facility and the \$7.4 million medical office building. The increase in long term debt outstanding is attributable to bank loan advances totaling \$4.7 million used in the construction of the medical office building, less \$575,000 of debt retired on the hospital bond issue.

Total net assets decreased primarily due the extraordinary loss of \$4.1 million related to the disposal of the old hospital facility.

A summary of the HCH Consolidated Statement of Revenues, Expenses and Changes in Net Assets as of December 31, 2008 and 2007 is presented below in 000's.

	<u>2008</u>	<u>2007</u>	<u>\$ Change</u>	<u>% Change</u>
Revenue:				
Net Patient Service Revenue, net of provision For Bad Debt: 2008 (\$6,259); 2007(\$4,712)	\$40,186	\$35,180	\$5,006	14.2%
Other	1,241	1,319	(78)	-5.9%
Total Operating Revenue	<u>41,427</u>	<u>36,499</u>	<u>4,928</u>	<u>13.5%</u>
Expenses:				
Salaries and Benefits	20,935	18,740	2,195	11.7%
Medical Supplies and Drugs	3,435	3,311	124	3.7%
Depreciation and Amortization	4,624	2,118	2,506	118.3%
Other	11,896	8,878	3,018	34.0%
Total Operating Expenses	<u>40,890</u>	<u>33,047</u>	<u>7,843</u>	<u>23.7%</u>
Operating Income	537	3,452	(2,915)	-84.4%
Non-Operating Revenue	697	1,117	(420)	-37.6%
Non-Operating Expense	(1,244)	(12)	(1,232)	10266.7%
Excess (Deficiency) of Revenue over (under) Expenses	(10)	4,557	(4,567)	-100.2%
Capital Grants and Contributions	0	655	(655)	-100.0%
Extraordinary Items	(4,120)	0	(4,120)	-100.0%
Total Net Assets - Beginning of Year	<u>54,523</u>	<u>49,311</u>	<u>5,212</u>	<u>10.6%</u>
Total Net Assets - End of Year	<u><u>\$50,393</u></u>	<u><u>\$54,523</u></u>	<u><u>(\$4,130)</u></u>	<u><u>-7.6%</u></u>

Sources of Revenue

During 2008 and 2007 HCH derived substantially all of its revenue from patient service and other related programs. Revenue is received from Medicare and Medicaid programs, self pay patients, insurance carriers, preferred provider organizations, and managed care companies. Other revenue includes payments from Harrison County for the operation of the county ambulance service, totaling \$724,472 in 2008 and \$828,710 in 2007.

The following table presents the percentages of gross revenue for patient services, by payor, for the years ended December 31, 2008 and 2007, respectively.

Payor	2008	2007
Medicare	44.0%	44.8%
Medicaid	11.7%	10.7%
Anthem	18.0%	16.7%
Commercial Insurance	6.3%	6.5%
Managed Care	10.2%	12.8%
Self Pay	7.2%	5.6%
Other	2.6%	2.9%
Total	100.0%	100.0%

Operating and Financial Performance

The financial operating performance of HCH receded in 2008 compared to the prior year. This section will discuss the highlights of 2008 operations and changes in activity.

Revenue

Net patient revenue increased 14.2% during 2008 primarily as a result of a special one-time catch-up distribution from the Indiana Medicaid Municipal Disproportionate Share program of \$1.9 million (net), and increased cost-based reimbursements under the federal Medicare program totaling \$2.4 million due to increased operating expenses related to the move to the new facility. These amounts were partially offset by increases totaling \$2 million in charity care and bad debts. A 4% decrease in inpatient volumes and a 2% decrease in outpatient volumes were mostly offset with an overall rate increase on services. Further discussion of revenue activity follows.

- Overall outpatient visits to HCH decreased by 2% in 2008. This decline is primarily the result of increased competition for diagnostic testing, which declined by 7%, as several members of the hospital's medical staff have expanded the provision of diagnostic testing within their offices. The impact of this decline

was partially offset by a 16% increase in emergency room visits, partially attributable to the relocation to the new facility in early 2008.

- Inpatient activity decreased in terms of patient days by 4%. This decrease reflects mild cold, flu and allergy seasons in 2008, which resulted in fewer elderly and chronically ill patients requiring acute care. Historical inpatient activity remains flat, which reflects the continued shift in the industry from inpatient services to outpatient services, as technology improves to allow less invasive procedures and shorten the time of recovery.
- The portion of deductions from gross revenue recognized by HCH for uninsured care and charity care in 2008 was \$8.2 million, or 9.8% of gross revenue, compared to \$6.2 million, or 7.8% of gross revenue in 2007. This increase is primarily attributable to a 36% increase in the volume of care provided to individuals without insurance during 2008. Uninsured care is included in provision for bad debt expense and represents uncollected charges for services not covered by insurance, and for patients that do not have health insurance. Charity care is recognized as a deduction from gross revenue, and represents charges written off that were incurred in providing care to uninsured and indigent patients. HCH has a policy and a commitment to provide emergency care to all patients without regard for their ability to pay for services. Over the past several years there has been a trend of increasing uninsured care, which greatly accelerated in 2008. This can be attributed to the overall local economy and the health insurance industry climate, which has left more of the population without health insurance. In addition, those with health insurance often face significant increases in patient deductibles and co-insurance as companies try to offset large health insurance premium increases by shifting toward consumer driven health plans.
- During 2008 net Medicare settlements of \$971,238 were received for the years 2007 and 2008, relating to the Medicare cost reports for those years. Under the Critical Access Hospital program, estimated interim payments are made by Medicare during the year, and then an initial settlement is made based on the cost report. The cost report determines the allowable cost of providing service to Medicare patients. The cost reports are then subject to subsequent reviews and audits, which may adjust the payment received or made on the initial settlement.
- Settlements totaling \$3,273,306 were received in 2008 under the Indiana Medicaid program, relating to the State of Indiana's fiscal years of 2006, 2007 and 2008. These payments were made as part of the Disproportionate Share Hospital program, and are recorded as offsets to revenue adjustments in the HCH accounting records. These payments were made from funds that are available to partially cover the hospital's cost of care to Medicaid and uninsured patients. These amounts are determined by the State through subsequent reviews and audits.

Expenses

Total operating expenses increased by 23.7% in 2008. Factors that had an impact on expenses are discussed below.

- Salaries and benefits costs for 2008 increased by \$2,195,000, a 12% increase from 2007. The number of full time equivalents (FTE's) increased 7.5% to an average of 375 for 2008, up from 248 in 2007. Approximately one-half of this increase was in line with budgeted projections, with the balance due to the addition of employed physicians that were not originally budgeted and unanticipated additional staff needed for the new facility. Departments adding staff for facility-related reasons include: dietary, housekeeping, admitting and human resources (9 FTE's). Nursing staffing was increased to accommodate an added transitional care unit (TCU) in the new facility and to accommodate significant volume increases in the emergency department (11 FTE's). Also, HCH added and expanded several physician practices during 2008 (6 FTE's). Wage and salary rate increases averaged 4% for 2008, a reflection of the current high inflation indexes associated with healthcare labor and benefit costs.
- All operating expenses other than salaries and benefits rose by \$5,648,000, an increase of 39.5% from 2007. The majority of this increase is related to the move into the new facility in early 2008. Expenses for depreciation and amortization increased by \$2,506,000 over 2007. This increase is due to the new facility being placed into service in early 2008, along with a substantial investment in new equipment in order to stay current with advancing technologies. Also, furnishings and equipment for the new facility totaling \$1,824,000, and costing less than the hospital's capitalization limit of \$5,000 per item, were expensed in 2008, accounting for more than 90% of the increase in other supplies. Purchased services increased \$568,000, due to additional expenses for contracted services for facility transition planning and the physical move to the new facility. Also, utilities increased by \$584,000, primarily attributable to the larger size of the new facility, but also reflecting the cost of utilities provided at the old facility until ownership was transferred to the county in mid-2008.
- Non-operating revenue decreased \$420,000, due primarily to declining interest rates on funds invested. A \$1,232,000 increase in non-operating expense reflects 10 ½ month of interest on the bond issue for the new facility that was placed in service in mid-February, along with a small amount of interest related to the loan financing the new medical office building that was placed in service near the end of 2008. An extraordinary loss of \$4,120,000 represents the loss that was recognized on the disposal of the old hospital facility and related equipment.

Long Term Debt

At fiscal year end 2008, HCH had total notes payable of \$34.2 million, which reflects \$4.8 million advanced on a bank loan during 2008, for the construction of a new medical office building adjoining the hospital, less \$575,000 of hospital revenue bonds retired. The \$29.4 million balance represents revenue bonds that HCH issued for the construction of the new hospital facility. Annual principal payments on these bonds began in October, 2008, with interest being paid monthly. Monthly principal and interest payments on the medical office building loan are scheduled to begin in March, 2009. More detailed information on HCH's long term debt is presented in the Notes to the Financial Statements.

CAPITAL ASSETS

During 2008 HCH invested \$8.5 million in various capital assets. A summary of the capital assets is presented below, in 000's:

	<u>2008</u>	<u>2007</u>	<u>\$ Change</u>	<u>% Change</u>
Land and Land Improvements	\$6,636	\$1,762	\$4,874	276.6%
Buildings and Fixed Equipment	42,135	15,187	26,948	177.4%
Equipment	17,816	13,609	4,207	30.9%
Total Capital Assets	<u>66,587</u>	<u>30,558</u>	<u>36,029</u>	117.9%
Less Accumulated Depreciation	(10,398)	(20,621)	10,223	(49.6%)
Construction in Progress	<u>1,490</u>	<u>43,353</u>	<u>(41,863)</u>	(96.6%)
Capital Assets - Net	<u>\$57,679</u>	<u>\$53,290</u>	<u>\$4,389</u>	8.2%

HCH continues to invest in capital equipment in order to meet the needs of the service area population. These capital improvements result in increased service capacity, greater efficiencies, and upgraded technology. Additionally, HCH continues to replace equipment as it becomes obsolete, as well as upgrade the capabilities of the hospital information systems. The large decrease in Construction in Progress in 2008 is due to the replacement hospital building and related equipment being placed into service in early 2008.

In connection with the move to a new hospital campus, certain capital assets were retired or disposed of in 2008. A summary of those assets is presented below, in 000's.

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Book Value 06/30/08</u>
Transferred to Harrison County:			
Land and Land Improvements	\$597,394	\$564,049	\$33,345
Buildings and Fixed Equipment	<u>13,424,705</u>	<u>9,803,173</u>	<u>3,621,532</u>
Totals	<u>\$14,022,099</u>	<u>\$10,367,222</u>	<u>\$3,654,877</u>
To be Held for Future Disposition:			
Land and Land Improvements	\$446,248	\$261,753	\$184,495
Buildings	<u>646,135</u>	<u>361,247</u>	<u>284,888</u>
Totals	<u>\$1,092,383</u>	<u>\$623,000</u>	<u>\$469,383</u>

The market value for the assets held for future disposition has not been determined as of the date of this report. These assets consist of single story physician office buildings and an EMS office and garage, as well as the land and improvements connected with these structures. The final disposition of these properties has not been determined as of the date of this report.

In addition, MRI equipment which was an operating lease buyout and a related modular building were sold for \$361,500 in 2008, resulting in a loss on disposal of \$342,764. This loss is included in the extraordinary loss on disposal of the old facility. Other equipment and furnishings which had minimal book value were donated or sold at auction in 2008.

The table below shows HCH's 2009 capital budget with projected spending of \$2.6 million for capital projects. Equipment to be placed in service in 2009 will be purchased from operating cash and cash reserves. The emergency medical services building will be funded with a \$750,000 grant from Harrison County and \$290,000 from HCH cash reserves.

Capital Budget (in 000's)	2009
Replacement Equipment	\$885
Information Systems	694
EMS Building	<u>1,040</u>
Total Capital Budget	<u>\$2,619</u>

More information on HCH's capital assets is presented in the Notes to the Financial Statements.

Economic and Industry Factors for 2009 Budget

The HCH Board of Trustees and management considered many factors when setting the 2009 budget. Of primary importance in setting the budget was the status of the economy and industry trends, which takes into account market forces and regulatory factors such as the following items:

- Population growth, demographic shifts, and the expanding need for services
- Continuously increasing expectations for quality improvement
- Advances in medical equipment technology and the need to replace obsolete equipment
- Privacy legislation – Health Insurance Portability and Accountability Act (HIPAA)

- Increasing emphasis on the integrity of public financial information
- Growing number of uninsured and underinsured patients
- Increasing costs of labor, medical supplies and drugs, and insurance
- Access to additional capital, and management of cash and debt levels
- Cash and resource requirements needed for the replacement hospital building project

The focus of management is to implement a multi-year plan that will consider expanded services, continuous quality improvement, cost control, capital requirements, and financing in support of net asset improvement.

Contacting HCH's Financial Manager

This report is designed to provide our citizens, customers, and creditors with a general overview of HCH's finances and to demonstrate accountability. If you have questions about this report or need additional information, contact the Chief Financial Officer, Jeffrey L. Davis at 812-738-4251.

HARRISON COUNTY HOSPITAL
STATEMENT OF NET ASSETS
December 31, 2008

<u>Assets</u>	<u>Primary Government</u>	<u>Discrete Component Unit</u>	<u>Total Reporting Entity</u>
Current assets:			
Cash and cash equivalents	\$ 1,450,990	\$ 90,246	\$ 1,541,236
Short-term investments	12,600,092	-	12,600,092
Patient accounts receivable, net of estimated uncollectibles of \$7,153,760	4,655,924	-	4,655,924
Estimated third-party settlements	2,792,665	-	2,792,665
Supplies and other current assets	3,596,922	539,602	4,136,524
Noncurrent cash and investments:			
Internally designated	5,267,667	-	5,267,667
Held by trustee for construction	1,556,960	-	1,556,960
Restricted by contributors and grantors	23,887	-	23,887
Capital assets:			
Land and construction in progress	4,685,301	-	4,685,301
Depreciable capital assets, net of accumulated depreciation	45,895,630	7,098,052	52,993,682
Other assets:			
Investment in affiliated company	1,322,311		1,322,311
Other	443,796	139,379	583,175
Total assets	<u>\$ 84,292,145</u>	<u>\$ 7,867,279</u>	<u>\$ 92,159,424</u>
<u>Liabilities and Net Assets</u>			
Current liabilities:			
Current maturities of long-term debt	\$ 595,000	\$ 73,520	\$ 668,520
Accounts payable and accrued expenses	3,894,438	613,281	4,507,719
Other current liabilities	1,826,892	925,616	2,752,508
Long-term debt, net of current maturities	28,830,000	4,685,616	33,515,616
Other long-term liabilities	321,830	-	321,830
Total liabilities	<u>35,468,160</u>	<u>6,298,033</u>	<u>41,766,193</u>
Net assets:			
Invested in capital assets, net of related debt	21,155,931	1,569,246	22,725,177
Restricted:			
Expendable for capital acquisitions	23,887	-	23,887
Unrestricted	27,644,167	-	27,644,167
Total net assets	<u>48,823,985</u>	<u>1,569,246</u>	<u>50,393,231</u>
Total liabilities and net assets	<u>\$ 84,292,145</u>	<u>\$ 7,867,279</u>	<u>\$ 92,159,424</u>

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year Ended December 31, 2008

	Primary Government	Discrete Component Unit	Total Reporting Entity
Operating revenues:			
Net patient service revenue (net of provision for bad debt)	\$ 40,186,498	\$ -	\$ 40,186,498
Other	<u>1,209,602</u>	<u>31,043</u>	<u>1,240,645</u>
Total operating revenues	<u>41,396,100</u>	<u>31,043</u>	<u>41,427,143</u>
Operating expenses:			
Salaries and benefits	20,935,330	-	20,935,330
Professional fees and purchased services	6,683,965		6,683,965
Medical supplies and drugs	3,434,748	-	3,434,748
Insurance	572,937	-	572,937
Other supplies	3,245,131	-	3,245,131
Depreciation and amortization	4,597,757	26,602	4,624,359
Other	<u>1,302,265</u>	<u>91,235</u>	<u>1,393,500</u>
Total operating expenses	<u>40,772,133</u>	<u>117,837</u>	<u>40,889,970</u>
Operating income (loss)	<u>623,967</u>	<u>(86,794)</u>	<u>537,173</u>
Nonoperating revenues (expenses):			
Investment income	644,962	-	644,962
Interest expense	(1,140,407)	(13,646)	(1,154,053)
Noncapital grants and contributions	52,483	-	52,483
Loss on sale of equipment	<u>(90,388)</u>	<u>-</u>	<u>(90,388)</u>
Total nonoperating expenses	<u>(533,350)</u>	<u>(13,646)</u>	<u>(546,996)</u>
Excess (deficiency) of revenues over (under) expenses before distributions and extraordinary items	90,617	(100,440)	(9,823)
Distributions	-	(235)	(235)
Extraordinary items (Note II, J)	<u>(4,119,829)</u>	<u>-</u>	<u>(4,119,829)</u>
Decrease in net assets	(4,029,212)	(100,675)	(4,129,887)
Net assets beginning of the year	<u>52,853,197</u>	<u>1,669,921</u>	<u>54,523,118</u>
Net assets end of the year	<u>\$ 48,823,985</u>	<u>\$ 1,569,246</u>	<u>\$ 50,393,231</u>

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS
Year Ended December 31, 2008

	<u>2008</u>
Cash flows from operating activities:	
Receipts from and on behalf of patients	\$ 39,828,172
Payments to suppliers and contractors	(15,744,066)
Payments to employees	(20,651,606)
Other receipts and payments, net	<u>(1,620,506)</u>
Net cash provided by operating activities	<u>1,811,994</u>
Cash flows from noncapital financing activities:	
Noncapital grants and contributions	52,483
Other	<u>(187,842)</u>
Net cash used by noncapital financing activities	<u>(135,359)</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(7,483,592)
Principal paid on long-term debt	(575,000)
Interest paid on long-term debt	<u>(1,140,407)</u>
Net cash used by capital and related financing activities	<u>(9,198,999)</u>
Cash flows from investing activities:	
Interest and dividends on investments	638,463
Purchase of investments	(12,199,773)
Proceeds from sale of investments	<u>16,486,322</u>
Net cash provided by investing activities	<u>4,925,012</u>
Net decrease in cash and cash equivalents	(2,597,352)
Cash and cash equivalents at beginning of year	<u>4,437,819</u>
Cash and cash equivalents at end of year	<u>\$ 1,840,467</u>
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents in current assets	\$ 1,450,990
Internally designated cash and cash equivalents	365,590
Restricted cash and cash equivalents	<u>23,887</u>
Total cash and cash equivalents	<u>\$ 1,840,467</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 623,967
Adjustments to reconcile operating income to net cash flows provided in operating activities:	
Depreciation and amortization	4,597,757
Provision for bad debts	6,259,449
(Increase) decrease in current assets:	
Patient accounts receivable	(6,617,775)
Estimated third-party payor settlements	(1,527,678)
Supplies and other current assets	333,423
Increase (decrease) in current liabilities:	
Accounts payable and accrued expenses	(2,045,159)
Other current liabilities	<u>188,010</u>
Net cash provided in operating activities	<u>\$ 1,811,994</u>

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

Harrison County Hospital (Hospital) is a county-owned facility and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital provides short-term inpatient and out-patient health care.

The Board of County Commissioners of Harrison County appoints the Governing Board of the Hospital and a financial benefit/burden relationship exists between the County and the Hospital. For these reasons, the Hospital is considered a component unit of Harrison County.

The accompanying financial statements present the activities of the Hospital (primary government) and its significant component unit. The component unit discussed below is included in the Hospital's reporting entity because of the significance of their operational or financial relationships with the Hospital. Blended component units, although legally separate entities, are in substance part of the government's operations and exist solely to provide services for the government; data from these units is combined with data of the primary government. Discretely presented component units are involved in activities of an operational nature independent from the government; their transactions are reported in a separate column in the basic financial statements to emphasize that it is legally separate from the Hospital.

Discretely Presented Component Unit

The Harrison MOB, LLC, was created on July 26, 2006, and is a significant component unit of the Hospital. The Harrison MOB, LLC, is fiscally dependent on the primary government.

The financial statements of the individual component unit may be obtained from their respective office as follows:

Harrison County Hospital
1141 Hospital Drive NW
Corydon, IN 47112

Separate audit report is prepared for the individual component unit.

B. Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

C. Assets, Liabilities and Net Assets or Equity

1. Deposits and Investments

Cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Short-term investments are investments with remaining maturities of up to 90 days.

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

Nonparticipating certificates of deposit, demand deposits, and similar nonparticipating negotiable instruments that are not reported as cash and cash equivalents are reported as investments at cost.

Debt securities are reported at fair value. Debt securities are defined as securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

Money market investments that mature within one year or less at the date of their acquisition are reported at amortized cost. Other money market investments are reported at fair value.

Investments in affiliated companies are reported using the equity method of accounting, or at cost, as applicable.

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating revenues in the Statement of Revenues, Expenses, and Changes in Net Assets.

2. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

3. Capital Assets

Capital assets, which include land, land improvements, buildings and improvements, and equipment, are reported at actual or estimated historical cost based on appraisals or deflated current replacement cost. Contributed or donated assets are reported at estimated fair value at the time received.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods and estimated useful lives of capital assets reported in the financial statements are as follows:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

	Capitalization Threshold	Depreciation Method	Estimated Useful Life
Land	\$ 5,000	Not applicable	Not applicable
Land improvements	5,000	Straight-line	AHA guide
Buildings and fixed equipment	5,000	Straight-line	AHA guide
Equipment	5,000	Straight-line	AHA guide

For depreciated assets, the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. The total interest expense capitalized by the Hospital during the current year was \$77,875. The total interest capitalized by the discrete component unit during the current year was \$77,350.

4. 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 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 Hospital, including amounts deposited with trustees as required by revenue bond indentures, discussed in Note II G.

Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Net assets of the discrete component unit are classified in one component:

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.

D. Grants and Contributions

From time to time, the Hospital receives grants from Harrison County and the State of Indiana 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 and expenses.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

From time to time, the Harrison MOB, LLC, receives contributions from Harrison County Hospital, individuals and private organizations. Revenues from contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. 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 and expenses.

E. Restricted Resources

When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

F. Operating Revenues and Expenses

The Hospital's Statement of Revenues, Expenses, and Changes in Net Assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Hospital's principal activity. Nonexchange revenues, including grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

G. Compensated Absences

The Hospital's policy on paid days off (which includes vacation, sick leave, personal leave, and holidays) allows full-time employees and regular part-time employees to accrue paid days off, to a maximum of 60 days.

Paid days off are accrued when incurred and reported as a liability.

II. Detailed Notes

A. Deposits and Investments

1. Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 16-22-3-16 requires only that money in the Hospital funds be deposited in the manner determined by the governing board. The Hospital does not have a formal policy regarding custodial credit risk for deposits. The bank balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

Custodial credit risk is the risk that, in the event of a bank failure, Harrison MOB, LLC's deposits may not be returned to it. Harrison MOB, LLC maintains its cash at financial institutions. At times, the balances may be in excess of federally insured limits.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Investments

As of December 31, 2008, the Hospital had the following investments:

Investment Type	Primary Government	Investment Maturities (in Years)		
	Market Value	Less Than 1	1-2	More Than 2
U.S. treasuries and securities	\$ 1,556,960	\$ 1,556,960	\$ -	\$ -

Statutory Authorization for Investments

Indiana Code 16-22-3-20 authorizes the Hospital to invest in: (1) any interest bearing account that is authorized to be set up and offered by a financial institution or brokerage firm registered and authorized to do business in Indiana; (2) repurchase or resale agreements involving the purchase and guaranteed resale of any interest bearing obligations issued or fully insured or guaranteed by the United States or any United States government agency in which type of agreement the amount of money must be fully collateralized by interest bearing obligations as determined by the current market value computed on the day the agreement is effective; (3) mutual funds offered by a financial institution or brokerage firm registered and authorized to do business in Indiana; (4) securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency; or (5) pooled fund investments for participating hospitals offered, managed, and administered by a financial institution or brokerage firm registered or authorized to do business in Indiana.

Investment Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Hospital does not have a formal investment policy for custodial credit risk for investments. At December 31, 2008, the Hospital did not hold investments with custodial credit risk.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Hospital's investments did not have credit risk.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a Hospital's investment in a single issuer. The Hospital does not have a policy in regards to concentration of credit risk. United States of America government and United States of America governmental agency securities are exempt from this policy requirement. The Hospital's investments did not have concentration of credit risk.

Foreign Currency Risk

The Hospital does not have a formal policy in regards to foreign currency risk. The Hospital's investments did not have foreign currency risk.

B. Accounts Receivable and Payable

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at year end consisted of these amounts:

Patient Accounts Receivable

Receivable from patients and their insurance carriers	\$ 7,985,813
Receivable from Medicare	3,098,508
Receivable from Medicaid	<u>725,363</u>
Total patient accounts receivable	11,809,684
Less allowance for uncollectible amounts	<u>7,153,760</u>
Patient accounts receivable, net	<u>\$ 4,655,924</u>

Accounts Payable and Accrued Expenses

Payable to employees	\$ 745,066
Payable to suppliers	3,096,994
Other	<u>52,378</u>
Total accounts payable and accrued expenses	<u>\$ 3,894,438</u>

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

C. Capital Assets

Capital asset activity for the year ended December 31, 2008, was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 895,186	\$ 2,300,074	\$ -	\$ 3,195,260
Construction in progress	41,248,181	5,081,792	44,839,932	1,490,041
 Total capital assets, not being depreciated	 42,143,367	 7,381,866	 44,839,932	 4,685,301
Capital assets, being depreciated:				
Land improvements	867,101	3,139,429	565,426	3,441,104
Buildings and fixed equipment	15,186,702	33,286,732	13,461,051	35,012,383
Equipment	13,609,288	9,084,882	4,877,927	17,816,243
 Totals	 29,663,091	 45,511,043	 18,904,404	 56,269,730
Less accumulated depreciation for:				
Land improvements	807,841	197,410	541,005	464,246
Buildings and fixed equipment	10,369,060	1,853,066	9,921,894	2,300,232
Equipment	9,444,029	2,642,768	4,477,175	7,609,622
 Totals	 20,620,930	 4,693,244	 14,940,074	 10,374,100
 Total capital assets, being depreciated, net	 9,042,161	 40,817,799	 3,964,330	 45,895,630
 Total primary government capital assets, net	 \$ 51,185,528	 \$ 48,199,665	 \$ 48,804,262	 \$ 50,580,931
 <u>Discretely Presented Component Unit</u>				
Capital assets, not being depreciated:				
Construction in progress	\$ 2,104,672	\$ -	\$ 2,104,672	\$ -
Capital assets, being depreciated:				
Buildings	-	4,679,824	-	4,679,824
Improvements other than buildings	-	2,442,793	-	2,442,793
 Totals	 -	 7,122,617	 -	 7,122,617
Less accumulated depreciation for:				
Buildings	-	24,565	-	24,565
 Total capital assets, being depreciated, net	 -	 7,098,052	 -	 7,098,052
 Total discretely presented component unit capital assets, net	 \$ 2,104,672	 \$ 7,098,052	 \$ 2,104,672	 \$ 7,098,052

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

D. Construction Commitments

Construction work in progress is composed of the following:

<u>Primary Government</u>	<u>Total</u>	<u>Expended to</u>		<u>Required</u>
<u>Project</u>	<u>Project</u>	<u>December 31,</u>	<u>Committed</u>	<u>Future</u>
	<u>Authorized</u>	<u>2008</u>		<u>Funding</u>
Information systems	\$ 788,916	\$ 766,130	\$ 22,786	\$ -
New hospital-post construction	502,200	410,181	92,019	-
New medical office building	352,100	304,228	47,872	-
EMS Building	1,000,000	9,503	990,497	-
Totals	<u>\$ 2,643,216</u>	<u>\$ 1,490,041</u>	<u>\$ 1,153,175</u>	<u>\$ -</u>

E. Operating Leases

The Hospital has entered into various operating leases having initial or remaining noncancelable terms exceeding one year for office space. Rental expenditures for these leases were \$60,261. The following is a schedule by years of future minimum rental payments as of year end:

2009	\$ 60,261
2010	60,261
2011	<u>45,196</u>
Total	<u>\$ 165,718</u>

F. Long-Term Liabilities

1. Revenue Bonds

The Hospital issues bonds to be paid by income derived from the acquired or constructed assets. Revenue bonds outstanding at year end are as follows:

<u>Purpose</u>	<u>Interest</u>	<u>Amount</u>
	<u>Rates</u>	
2005 Hospital construction revenue bonds	Variable	<u>\$ 29,425,000</u>

Disclosure information for the 2005 Revenue Bond Issue, which includes interest rate swap agreements, follows:

As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in November 2005, the Hospital entered into an interest rate swap in connection with its \$30,000,000 Series 2005 auction rate bond. The intention of the swap was to effectively change the Hospital's variable interest rate on the bond to a synthetic fixed rate of 3.55%.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Under the swap agreement, the Hospital pays the counterparty, U.S. Bancorp Piper Jaffray Financial Products Inc., a fixed payment of 3.81% and receives a variable payment computed as 70% of the London Interbank Offered Rate (LIBOR). The swap has equal notional amount totaling \$25,000,000 and the associated auction rate bonds have a \$25,000,000 principal amount. The swap was entered into at the same time the bonds were issued in November 2005. The notional value of the swap declined by \$575,000 in 2008 and in increasing amounts in future years as the principal amount of the associated debt declines. The auction rate on the bonds closely approximates the Bond Market Association Municipal Swap Index (BMA). The bonds and related swap agreement mature on October 1, 2032. As of December 31, 2008, rates were as follows:

	Terms	Rates (%)
Interest rate swap:		
Fixed payment to counterparty	Fixed	3.81%
Variable payment from counterparty	70% of LIBOR	<u>1.90%</u>
Net interest rate swap payments		1.91%
Variable auction-rate bond payments		<u>2.32%</u>
Synthetic interest rate of bonds		<u>4.23%</u>

As of December 31, 2008, the swap had a negative fair value of \$4,900,459. The negative fair value of the swap may be countered by reductions in total interest payments required by the auction rate bond, creating lower synthetic rates. Because the auction rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase.

As of December 31, 2008, the Hospital was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the Hospital would be exposed to credit risk in the amount of the derivative's fair value. The swap counterparty is currently rated A+ by Standard & Poor's, Aa3 by Moody's Investors Service and AA- by Fitch Ratings. The swap agreement does not contain collateral provisions for either party.

The swap exposes the Hospital to basis risk should the relationship between LIBOR and auction rates converge, changing the synthetic rate on the bonds. If a change occurs that results in the rate moving to convergence, the expected cost savings may not be realized.

The derivative contracts use the International Swaps and Derivatives Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Schedules to the Master Agreements include additional termination events. The swap may be terminated by the Hospital if the counterparty's credit rating falls below BBB- by Standard & Poor's, Aa3 by Moody's Investors Service or if either rating is withdrawn or suspended. The counterparty may terminate the swap agreement if the Hospital's rating by Standard & Poor's falls below BBB- or the rating is withdrawn or suspended. Either party may terminate the swap if the other fails to perform under the terms of the contract. If the swap is terminated, the auction rate bonds would no longer carry a synthetic interest rate. Also, if at the time of termination the swap has a negative fair value, the Hospital would be liable to the counterparty for a payment equal to the swap's fair value.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

As of December 31, 2008, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their terms were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Year Ending December 31	Variable-Rate Bonds		Interest Rate	Total
	Principal	Interest	Swap, Net	Debt Service
2009	\$ 595,000	668,856	550,653	\$ 1,814,509
2010	675,000	653,196	537,761	1,865,957
2011	865,000	633,128	521,239	2,019,367
2012	895,000	612,364	504,145	2,011,509
2013	930,000	590,788	486,382	2,007,170
2014-2018	5,160,000	2,603,272	2,143,211	9,906,483
2019-2023	6,145,000	1,937,548	1,595,137	9,677,685
2024-2028	7,315,000	1,145,152	942,776	9,402,928
2029-2032	6,845,000	244,992	201,696	7,291,688
Totals	<u>\$ 29,425,000</u>	<u>\$ 9,089,296</u>	<u>\$ 7,483,000</u>	<u>\$ 45,997,296</u>

2. Harrison MOB, LLC, Note Payable

Long-term debt at December 31, 2008 was as follows:

Note payable in monthly installments of interest only at one month LIBOR plus 1.35% (1.786% at 12/31/08)	\$ 4,759,136
Less current maturities	<u>73,520</u>
Total long-term debt	<u>\$ 4,685,616</u>

Harrison MOB, LLC, (LLC) entered into a credit agreement in July 2007 to finance the construction of a medical office building. During construction, the agreement required payments of interest only on the outstanding balance. Upon substantial completion of the building, the agreement requires the commencement of principal payments to repay the obligation over 25 years. At December 31, 2008, the building was still under construction and no principal was currently due. In February 2009, the building was deemed substantially complete and the LLC started making principal payments to amortize the balance of the loan of \$5,440,000 over 25 years.

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, the LLC entered into an interest rate swap agreement to cover this floating rate debt. The agreement provides for the LLC to receive interest from the counterparty at one month LIBOR plus 1.35% and to pay interest to the counterparty at a fixed rate of 7.22% on the outstanding notional amount. Under the agreement, the LLC will pay or receive the net interest amount monthly. This agreement became effective in February 2009 which coincides with the commencement of principal payments on the note payable.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2008 was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable:					
Revenue:					
Indiana Health and Educational Facility Financing Authority	<u>\$ 30,000,000</u>	<u>\$ -</u>	<u>\$ 575,000</u>	<u>\$ 29,425,000</u>	<u>\$ 595,000</u>
Discretely Presented Component Units					
General long-term debt	<u>\$ 42,445</u>	<u>\$ 4,716,691</u>	<u>\$ -</u>	<u>\$ 4,759,136</u>	<u>\$ 73,520</u>

4. Net Revenue Available for Debt Service

The following disclosures concerning net revenue available for debt service applicable to the years ended December 31, 2008, are required by terms of the financing agreement between the Hospital and IHFFA:

Revenue from operations	\$ 41,396,100
Investment income	644,962
Less:	
Net loss on disposal of assets	90,388
Expenses (excluding depreciation, amortization and interest on funded debt)	<u>36,174,376</u>
Total net revenue available for debt service	<u>\$ 5,776,298</u>
Funded debt service for year	<u>\$ 1,761,088</u>
Historical debt service coverage ratio	<u>3:28</u>

G. Restricted Net Assets

Hospital restricted, expendable net assets are available for the following purposes:

	<u>2008</u>
Expendable for capital acquisitions	
Building and equipment	<u>\$ 23,887</u>

H. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were \$1,997,507 for 2008.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

I. Internally Designated Assets

Noncurrent cash and investments internally designated include the following:

Funded Depreciation – Amounts transferred from the Operating Fund by the Hospital Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the Hospital buildings as authorized by IC 16-22-3-13.

Internally designated:

Funded depreciation:

Cash and cash equivalents	\$ 365,590
Investments	3,599,681
Accrued interest receivable	42,633
Accrued receivable	<u>1,259,763</u>

Total internally designated	<u><u>\$ 5,267,667</u></u>
-----------------------------	----------------------------

J. Extraordinary Items

The Hospital constructed a hospital facility located at the campus of 1141 Hospital Drive, NW; Corydon, Indiana which was occupied on February 21, 2008. Hospital officials could not locate a buyer for the old hospital facility and the old medical office buildings located at the campus of 245 Atwood Street. Harrison County officials accepted the donation of these facilities on July 6, 2008, which included land, land improvements, and buildings with a book value of \$6,000, \$27,345, and \$3,621,532, respectively.

In addition to the facilities listed above, Hospital officials were holding other capital assets associated with the Hospital campus at 245 Atwood Street. Some of these assets were sold and the value of the sale was netted against the book value for a net adjusted loss of \$122,188.

The Hospital also bought a leased piece of equipment and sold it, for a loss of \$342,764, for a total extraordinary loss of \$4,119,829.

III. Other Information

A. Risk Management

The Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); and natural disasters.

The risks of torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; and natural disasters are covered by commercial insurance from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. There were no significant reductions in insurance by major category of risk.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Medical Benefits to Employees and Dependents

The Hospital has chosen to establish a risk financing fund for risks associated with medical benefits to employees and dependents. The risk financing fund is accounted for in the Operating Fund where assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of \$45,000 per year. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of payouts and other economic and social factors.

However, claim liabilities cannot be reasonably estimated.

B. Subsequent Events

The Hospital approved the construction of a new Emergency Medical Services (EMS) facility on the campus at 1141 Hospital Drive, NW, Corydon, Indiana, with an estimated cost of \$1,043,000. The Hospital approved up to \$293,000 toward funding of the facility, with the remainder to be funded with contributions.

C. Contingent Liabilities

Litigation

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

D. Fair Value of Financial Instruments

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

Cash and Cash Equivalents

The carrying amount reported in the statement of net assets for cash and cash equivalents approximates its fair value.

Short-Term Investments

The carrying amount reported in the statement of net assets is the investment's fair value on the day it becomes a short-term investment.

Investments

Fair values, which are the amounts reported in the statement of net assets, are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Accounts Payable and Accrued Expenses

The carrying amount reported in the statement of net assets for accounts payable and accrued expenses approximates its fair value.

Estimated Third-Party Payor Settlements

The carrying amount reported in the statement of net assets for estimated third-party payor settlements approximates its fair value.

E. Investment in Affiliated Companies

Harrison-Floyd Health Services, LLC

In 2004, the Hospital entered into an agreement with Floyd Memorial Hospital and Health Services to establish and operate a limited liability company, Harrison-Floyd Health Services, LLC. In accordance with this agreement, each hospital invested \$150,000 for 50% equity interest in the LLC. The investment was made in the fiscal years 2004 and 2005. The LLC began operation in 2004. The investment is recorded on the equity method. The Hospital's investment in the affiliated company is included in the other assets category of the Statement of Net Assets.

Summarized financial information as of December 31, 2008, and for the year then ended from the unaudited financial statements of the affiliated company follows:

Current assets	\$	35,724
Noncurrent assets		111,854
Current liabilities		7,292
Net assets		140,286
Revenue		87,500
Expenses		115,373
Net loss		27,873

Harrison MOB, LLC

On July 26, 2006, the Hospital entered into an agreement with several physicians and physician groups to establish and operate a medical office building to be located on the Hospital's campus in Corydon, Indiana, known as Harrison MOB, LLC (LLC). In accordance with this agreement, 68 Class A units and 37 Class B units were sold for \$10,000 each, for an aggregate proceeds of \$1,050,000. Each unit represents an equity interest of approximately .952% in the company. The Hospital purchased 58 units for an investment of \$580,000 representing approximately 55.24% equity interest in the company. The medical office building was operational as of February 2009. The Hospital committed to lease available finished square footage in the building up to a 90% occupancy level for the first five years and up to 85% occupancy level for the next five years. The investment is recorded on the equity method. The Hospital's investment in the affiliated company is included in the other assets category of the Statement of Net Assets.

In July 2007, the LLC borrowed the principal amount of \$5,440,000 to finance the construction of a medical office building on the campus of Harrison County Hospital. The term of the loan will be 25 years. The note payable is secured by all the LLC's assets, assignments of rents and a guarantee by Harrison County Hospital.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Summarized financial information as of December 31, 2008, and for the year then ended from the audited financial statements of the affiliated company follows:

Current assets	\$ 629,848
Noncurrent assets	7,237,431
Current liabilities	1,612,417
Noncurrent liabilities	4,685,616
Net assets	1,569,246
Revenues	31,043
Expenses	42,548
Net loss	(11,505)

F. Estimated Third-Party Settlements

Regulations in effect require annual retroactive settlements for third-party settlements based upon cost reports filed by the Hospital. These retroactive settlements are estimated and recorded in the accompanying financial statements. Changes in these estimates are reflected in the year in which they occur. During 2008, net patient service revenues in the accompanying statements of operations were increased by \$2,709,833 to reflect changes in the estimated settlements for certain prior years.

G. Pension Plan

Hospital Pension Plan

Plan Description

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

MetLife
c/o FasCare LLC
P.O. Box 173768
Denver, Colorado 80217-3768
Ph. (800) 543-2520

Funding Policy and Annual Pension Cost

The contribution requirements of plan members are established by the written agreement between the Hospital Board of Trustees and the Plan Administrator. Plan members' contributions are voluntary and are established by written authorization for payroll deduction into an annuity savings account. The Hospital is required to contribute at an actuarially determined rate. The current rate is 5% of annual covered payroll. Employer and employee contributions to the plan for the year ending December 31, 2008, were \$566,105 and \$624,427, respectively.

HARRISON COUNTY HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on January 21, 2010, with Steven L. Taylor, Chief Executive Officer; Jeffrey L. Davis, Chief Financial Officer; Paul Martin, Chairman of the Hospital Board; Keith Lieber, Controller; and Donn Blank, member of the Hospital Board. Our audit disclosed no material items that warrant comment at this time.