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STATE OF INDIANA

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March 25, 2010

Board of Directors
Dunn Memorial Hospital
1600 23rd Street
Bedford, Indiana 47421

We have reviewed the audit report prepared by Blue & Company, LLC, Independent Public Accountants, for the period January 1, 2007 to December 31, 2007. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Dunn Memorial Hospital, as of December 31, 2007 and the results of its operations for the period then ended, on the basis of accounting described in the report.

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

STATE BOARD OF ACCOUNTS

DUNN MEMORIAL HOSPITAL

COMBINED FINANCIAL STATEMENTS

DECEMBER 31, 2007 AND 2006

CPAs / ADVISORS



DUNN MEMORIAL HOSPITAL

TABLE OF CONTENTS DECEMBER 31, 2007 AND 2006

	Page
Report of Independent Auditors	1
Required Supplementary Information	
Management's Discussion and Analysis (MD&A) (Unaudited).....	i
Combined Financial Statements	
Combined Balance Sheets.....	2
Combined Statements of Revenues, Expenses and Changes in Net Assets	4
Combined Statements of Cash Flows.....	5
Notes to Combined Financial Statements.....	7



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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Dunn Memorial Hospital
Bedford, Indiana

We have audited the accompanying combined balance sheets of Dunn Memorial Hospital (Hospital) and its discretely presented component unit, collectively a component unit of Lawrence County, as of December 31, 2007 and 2006 and the related combined statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

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

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

Management's discussion and analysis on pages i through vi are not a required part of the basic combined financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Blue & Co., LLC

January 16, 2009

REQUIRED SUPPLEMENTARY INFORMATION

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2007 AND 2006

This section of Dunn Memorial Hospital's (Hospital) annual combined financial statements presents background information and management's discussion and analysis of the Hospital's financial performance during the year ended December 31, 2007. This MD&A includes a discussion and analysis of the activities and results of the Hospital only and does not include the Hospital's discrete component unit. Please read this MD&A in conjunction with the Hospital's combined financial statements that follow.

FINANCIAL HIGHLIGHTS

- The Hospital reported a decrease in net assets of approximately \$2,320,000 for the year ended 2007, compared to a decrease in net assets of approximately \$634,000, in 2006.

USING THIS ANNUAL REPORT

The Hospital's combined 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 financial statements and related notes provide information about the activities and the financial position of the Hospital.

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

All of the current year revenue earned and expenses incurred are accounted for in the statement of revenues, expenses and changes in net assets.

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

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2007 AND 2006

THE HOSPITAL'S NET ASSETS

Assets, Liabilities, and Net Assets

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Assets			
Current assets	\$ 13,110,977	\$ 11,858,129	\$ 1,252,848
Capital assets, net	19,410,996	21,364,525	(1,953,529)
Assets whose use is limited	108,082	102,629	5,453
Other assets	<u>1,083,978</u>	<u>1,152,540</u>	<u>(68,562)</u>
Total assets	<u>\$ 33,714,033</u>	<u>\$ 34,477,823</u>	<u>\$ (763,790)</u>
Liabilities			
Current liabilities	\$ 13,531,146	\$ 11,868,064	\$ 1,663,082
Long-term debt	<u>675,854</u>	<u>782,563</u>	<u>(106,709)</u>
Total liabilities	14,207,000	12,650,627	1,556,373
Net assets			
Invested in capital assets, net of related debt	11,138,614	12,713,239	(1,574,625)
Unrestricted	<u>8,368,419</u>	<u>9,113,957</u>	<u>(745,538)</u>
Total net assets	<u>19,507,033</u>	<u>21,827,196</u>	<u>(2,320,163)</u>
Total liabilities and net assets	<u>\$ 33,714,033</u>	<u>\$ 34,477,823</u>	<u>\$ (763,790)</u>

The most significant change in the Hospital's current assets was a decrease in the estimated third party payor receivables of approximately \$1,200,000 that resulted from the Medicare cost report and Medicaid DSH & UPL payments. Capital assets, net decreased primarily due to depreciation expense exceeding capital asset additions.

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2007 AND 2006

OPERATING RESULTS AND CHANGES IN THE HOSPITAL'S NET ASSETS

Operating Results and Changes in Net Assets

	2007	2006	Change
Operating revenue			
Net patient service revenue	\$ 37,426,430	\$ 33,095,817	\$ 4,330,613
Other operating revenue	1,164,925	938,868	226,057
Total operating revenue	38,591,355	34,034,685	4,556,670
Operating expenses			
Salaries and benefits	23,793,945	20,821,834	2,972,111
Purchased services and professional fees	4,684,314	4,995,160	(310,846)
Depreciation and amortization	2,783,802	3,300,097	(516,295)
Other operating expenses	9,142,172	8,543,999	598,173
Total operating expenses	40,404,233	37,661,090	2,743,143
Operating loss	(1,812,878)	(3,626,405)	1,813,527
Nonoperating expense	(507,285)	(306,326)	(200,959)
Change in net assets before discontinued operations	(2,320,163)	(3,932,731)	1,612,568
Income from operations of discontinued component, including gain on disposal of \$2,749,594 in 2006	-0-	3,298,475	(3,298,475)
Change in net assets	(2,320,163)	(634,256)	(1,685,907)
Net assets beginning of year	21,827,196	22,461,452	(634,256)
Net assets end of year	\$ 19,507,033	\$ 21,827,196	\$ (2,320,163)

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2007 AND 2006

SOURCES OF REVENUE

During 2007, the Hospital derived substantially all of its revenue from patient service and other related activities. A significant portion of the patient service revenue is from patients that are insured by government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. Revenue from the Medicare and Medicaid programs accounted for approximately 45 percent and 12 percent, respectively, of the Hospital's gross patient revenue for the year ended 2007, and 49 percent and 11 percent, respectively, of the Hospital's gross patient revenue for the year ended 2006.

OPERATING AND FINANCIAL PERFORMANCE

The following section highlights the major financial factors for 2007:

- The Hospital's admissions declined from 2,084 in 2006 to 1,959 in 2007. The Hospital's adjusted patient days decreased to 25,728 in 2007, compared to 27,950 in 2006.
- The Hospital's net patient service revenue increased approximately \$4,331,000 during 2007, an 11% increase over 2006.
- Salaries and benefits was the expense classification with the largest increase over 2006. Salaries and benefits expense in 2007 increased approximately \$2,972,000 from 2006, representing an 11% change from 2006.

DISCONTINUED OPERATIONS

The Hospital sold its Dialysis Service line in 2006 and has reported its income from operations of approximately \$3,298,000 including the gain on disposal of approximately \$2,750,000 within the financial statements.

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2007 AND 2006

CAPITAL ASSETS

The change in capital assets is outlined in the following table:

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Land	\$ 750,982	\$ 750,982	\$ -0-
Land improvements	825,755	817,853	7,902
Buildings and improvements	26,293,486	26,153,375	140,111
Equipment	29,225,040	28,641,409	583,631
Construction in progress	<u>402,687</u>	<u>315,798</u>	<u>86,889</u>
Total capital assets	57,497,950	56,679,417	\$ 818,533
Less accumulated depreciation	<u>38,086,954</u>	<u>35,314,892</u>	<u>2,772,062</u>
Capital assets, net	<u>\$ 19,410,996</u>	<u>\$ 21,364,525</u>	<u>\$ (1,953,529)</u>

DEBT

The Hospital has the following debt outstanding totaling approximately \$8.8 million as of December 31, 2007:

- Note Payable
- 2003 revenue bonds
- Capital lease obligations

More detailed information about the Hospital's long-term debt is presented in the Notes to the Combined Financial Statements.

ECONOMIC OUTLOOK

Management believes that the healthcare industry's and the Hospital's operating margins will continue to be under pressure as a result of the changes in payor mix and growth in operating expenses, that exceed any increases in contractually arranged and legally established payments received for services provided. Another factor that poses a challenge to management is the increasing competitive market for the delivery of healthcare services. The Hospital will still be faced with the challenge of providing quality services in an increasingly competitive environment, while at the same time managing costs.

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2007 AND 2006

CONTACTING THE HOSPITAL'S FINANCIAL MANAGEMENT

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital business administration by telephoning 812-275-3331.

DUNN MEMORIAL HOSPITAL

COMBINED BALANCE SHEETS DECEMBER 31, 2007 AND 2006

	ASSETS			
	2007			2006
			Total reporting entity	Total reporting entity (Memorandum only)
	Hospital	Foundation		
Current assets				
Cash and cash equivalents	\$ 3,104,791	\$ 15,580	\$ 3,120,371	\$ 1,454,985
Investments	-0-	492,314	492,314	458,455
Patient accounts receivable, less allowance for uncollectible accounts of \$4,861,823 in 2007 and \$4,413,483 in 2006	7,113,916	-0-	7,113,916	6,092,985
Other receivables	215,567	-0-	215,567	383,272
Estimated third party payor receivables	1,274,994	-0-	1,274,994	2,472,180
Other current assets	1,401,709	6,922	1,408,631	1,472,906
Total current assets	13,110,977	514,816	13,625,793	12,334,783
Assets whose use is limited				
Board designated funds				
Investments	108,082	-0-	108,082	102,629
Total assets whose use is limited	108,082	-0-	108,082	102,629
Less current portion	-0-	-0-	-0-	-0-
Noncurrent assets whose use is limited	108,082	-0-	108,082	102,629
Capital assets				
Land	750,982	-0-	750,982	750,982
Construction in progress	402,687	-0-	402,687	315,798
Depreciable capital assets, net	18,257,327	-0-	18,257,327	20,297,745
	19,410,996	-0-	19,410,996	21,364,525
Other assets	1,083,978	-0-	1,083,978	1,152,540
Total assets	\$ 33,714,033	\$ 514,816	\$ 34,228,849	\$ 34,954,477

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED BALANCE SHEETS DECEMBER 31, 2007 AND 2006

LIABILITIES AND NET ASSETS

	2007			2006
			Total reporting entity	Total reporting entity (Memorandum only)
	Hospital	Foundation		
Current liabilities				
Note payable	\$ 498,699	\$ -0-	\$ 498,699	\$ 120,479
Current portion of long-term debt	7,596,528	-0-	7,596,528	7,868,723
Accounts payable	3,583,701	11,257	3,594,958	2,568,507
Salaries, wages and related payables	1,400,355	-0-	1,400,355	1,299,605
Other current liabilities	451,863	-0-	451,863	18,785
Total current liabilities	13,531,146	11,257	13,542,403	11,876,099
Noncurrent liabilities				
Derivative liability	991	-0-	991	-0-
Long-term capital lease obligations	674,863	-0-	674,863	782,563
Total noncurrent liabilities	675,854	-0-	675,854	782,563
Total liabilities	14,207,000	11,257	14,218,257	12,658,662
Net assets				
Invested in capital assets, net of related debt	11,138,614	-0-	11,138,614	12,713,239
Unrestricted	8,368,419	503,559	8,871,978	9,582,576
Total net assets	19,507,033	503,559	20,010,592	22,295,815
Total liabilities and net assets	\$ 33,714,033	\$ 514,816	\$ 34,228,849	\$ 34,954,477

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

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

	2007			2006
	Hospital	Foundation	Eliminations	Total reporting entity (Memorandum only)
Revenue				
Net patient service revenue	\$ 37,426,430	\$ -0-	\$ -0-	\$ 37,426,430
Other	1,164,925	94,364	(27,862)	1,231,427
Total operating revenue	38,591,355	94,364	(27,862)	38,657,857
Operating expenses				
Salaries and wages	19,828,819	-0-	-0-	19,828,819
Employee benefits	3,965,126	-0-	-0-	3,965,126
Purchased services and professional fees	4,684,314	-0-	-0-	4,684,314
Supplies and other	8,555,210	99,378	(47,862)	8,606,726
Insurance	586,962	-0-	-0-	586,962
Depreciation and amortization	2,783,802	-0-	-0-	2,783,802
Total operating expenses	40,404,233	99,378	(47,862)	40,455,749
Operating income (loss) from continuing operations	(1,812,878)	(5,014)	20,000	(1,797,892)
Nonoperating income (expenses)				
Investment income	16,475	39,954	-0-	56,429
Non-capital contributions	20,100	-0-	(20,000)	100
Interest expense	(543,860)	-0-	-0-	(543,860)
Total nonoperating income (expenses), net	(507,285)	39,954	(20,000)	(487,331)
Change in net assets before discontinued operations	(2,320,163)	34,940	-0-	(2,285,223)
Income from operations of discontinued component, including gain on disposal of \$2,749,594 in 2006	-0-	-0-	-0-	-0-
Change in net assets	(2,320,163)	34,940	-0-	(2,285,223)
Net assets				
Beginning of year	21,827,196	468,619	-0-	22,295,815
End of year	\$ 19,507,033	\$ 503,559	\$ -0-	\$ 20,010,592

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

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

	2007			2006
	Hospital	Foundation	Eliminations	Total reporting entity (Memorandum only)
Operating activities				
Cash received from patient services	\$ 37,602,685	\$ -0-	\$ -0-	\$ 37,602,685
Cash paid for salaries, wages and benefits	(23,693,195)	-0-	-0-	(23,693,195)
Cash paid to vendors and suppliers	(12,303,872)	(98,188)	-0-	(12,402,060)
Other receipts and payments, net	1,332,630	94,364	20,000	1,446,994
Net cash flows from operating activities	2,938,248	(3,824)	20,000	2,954,424
Non-capital financing activities				
Change in physician receivables	3,779	-0-	-0-	3,779
Non-capital contributions	20,100	-0-	(20,000)	100
Net cash flows from non-capital financing activities	23,879	-0-	(20,000)	3,879
Capital and related financing activities				
Proceeds from note payable	578,220	-0-	-0-	578,220
Payments on note payable	(200,000)	-0-	-0-	(200,000)
Payments on long-term debt	(667,868)	-0-	-0-	(667,868)
Interest on long-term debt	(509,576)	-0-	-0-	(509,576)
Proceeds from the sale of discontinued operations	-0-	-0-	-0-	-0-
Gain on sale of the discontinued operations	-0-	-0-	-0-	-0-
Income from discontinued operations	-0-	-0-	-0-	-0-
Purchase of capital assets	(530,557)	-0-	-0-	(530,557)
Net cash flows from capital and related financing activities	(1,329,781)	-0-	-0-	(1,329,781)
Investing activities				
Investment income	16,475	39,954	-0-	56,429
Other nonoperating income	19,747	-0-	-0-	19,747
Other changes in assets whose use is limited and investments	(5,453)	(33,859)	-0-	(39,312)
Net cash flows from investing activities	30,769	6,095	-0-	36,864
Net change in cash and cash equivalents	1,663,115	2,271	-0-	1,665,386
Cash and cash equivalents				
Beginning of year	1,441,676	13,309	-0-	1,454,985
End of year	\$ 3,104,791	\$ 15,580	\$ -0-	\$ 3,120,371
Reconciliation of cash and cash equivalents to the balance sheets				
Cash and cash equivalents				
In current assets	\$ 3,104,791	\$ 15,580	\$ -0-	\$ 3,120,371
In assets whose use is limited	-0-	-0-	-0-	-0-
Total cash and cash equivalents	\$ 3,104,791	\$ 15,580	\$ -0-	\$ 3,120,371

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

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

	2007			2006
	Hospital	Foundation	Eliminations	Total reporting entity (Memorandum only)
Reconciliation of operating income to net cash flows from operating activities				
Operating loss from continuing operations	\$ (1,812,878)	\$ (5,014)	\$ 20,000	\$ (1,797,892)
Adjustments to reconcile operating loss from continuing operations to net cash flows from operating activities				
Depreciation and amortization	2,783,802	-0-	-0-	2,783,802
Provision for bad debts	3,407,315	-0-	-0-	3,407,315
Changes in operating assets and liabilities				
Patient accounts receivable	(4,428,246)	-0-	-0-	(4,428,246)
Other receivables	167,705	-0-	-0-	167,705
Estimated third-party payor settlements	1,197,186	-0-	-0-	1,197,186
Other current assets	66,307	(2,032)	-0-	64,275
Other assets	-	-0-	-0-	-
Accounts payable	1,023,229	3,222	-0-	1,026,451
Salaries, wages and related payable	100,750	-0-	-0-	100,750
Other current liabilities	433,078	-0-	-0-	433,078
Net cash flows from operating activities	<u>\$ 2,938,248</u>	<u>\$ (3,824)</u>	<u>\$ 20,000</u>	<u>\$ 2,954,424</u>
Supplemental cash flows information				
Cash paid for interest	\$ 526,727	\$ -0-	\$ -0-	\$ 526,727
Noncash capital and related financing activities				
Capital lease obligation incurred for use of equipment	\$ 287,973	\$ -0-	\$ -0-	\$ 287,973

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

1. SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Dunn Memorial Hospital (Hospital) is an acute-care hospital located in Bedford, Indiana. The Hospital is a component unit of Lawrence County (County) and the Board of County Commissioners appoints members of the Board of Directors of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Lawrence County area. It also operates a home health agency in the same geographic area.

On July 14, 1978, the Board of County Commissioners of Lawrence County, upon written request of the Hospital Board of Directors, created the Dunn Memorial Hospital Association (Association). The Association was created pursuant to the provisions of Indiana Code 16-22-6 for the exclusive purpose of financing the constructing hospital facilities for the Hospital. Accordingly, the transactions of the Association are combined with the Hospital.

For financial purposes, the Hospital's reporting entity consists of the primary government and the component unit organization for which the nature and significance of its relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete, and it is financially accountable to the primary government (discrete component unit).

Discrete Component Unit

Discretely presented component units are reported in a separate column in the combined financial statements to emphasize they are legally separate from the primary government. They are financially accountable to the primary government, or have relationships with the primary government such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The discretely presented component unit is:

Dunn Memorial Foundation, Inc. (Foundation): A separate not-for-profit entity organized to support the operations of the Hospital. All significant transactions between the Hospital and the Foundation have been eliminated. Complete financial statements of the Foundation may be obtained from its Administrative Office at 1616 23rd St, Bedford, IN 47421.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Use of Estimates

The preparation of combined 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 combined financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Enterprise Fund Accounting

The Hospital utilizes the enterprise fund method of 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 of 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 issues after November 30, 1989, that do not conflict or contradict GASB pronouncements.

Risk Management

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

Cash and Cash Equivalents

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

Investments 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 and in nonnegotiable certificates of deposit are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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 and Net Patient Service Revenue

Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated adjustments under reimbursement agreements. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

The Hospital is a provider of services to patients entitled to coverage under Medicare. The Hospital was granted Critical Access Status by Medicare. The Hospital is paid for Medicare services based upon a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports.

Final determination of amounts earned is subject to review by the fiscal intermediary. At December 31, 2007, Medicare reports have been settled through 2005. Management believes adequate provision has been made in the financial statements for any adjustments.

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

Advertising

The Hospital expenses advertising costs as they are incurred. Advertising expenses for the years ended December 31, 2007 and 2006 were \$228,804 and \$269,339, respectively.

Inventories

Inventories are stated at the lower of cost, using the first-in, first-out (FIFO) method or market.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Assets Whose Use is Limited

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

Capital Assets

Capital assets, which include land, land improvements, buildings and improvements, and equipment, are reported at historical cost. Contributed or donated assets are reported at estimated fair value at the time received. Capital assets under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements.

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:

Description	Capitalization Threshold	Depreciation Method	Range of Useful Lives
Land improvements	\$ 500	Straight line	2-25 years
Buildings and improvements	\$ 500	Straight line	5-40 years
Equipment	\$ 500	Straight line	2-20 years

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

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.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Compensated Absences

The Hospital's 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. 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.

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 net assets are expendable noncapital net assets that must be used for a particular purpose, as specified by creditors or donors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. 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.

Grants and Contributions

From time to time, the reporting entity receives contributions from 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 for a specific operating purpose are reported as non-operating revenues. Amounts restricted for capital acquisitions are reported after non-operating revenues and expenses.

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.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Operating Revenues and Expenses

The reporting entity's combined statements of revenues, expenses and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the principal activity. Nonexchange revenues, including taxes, 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.

Charity Care

The Hospital provides care without charges or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue.

Fair Value of Financial Instruments

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

The fair values of assets whose use is limited are estimated based on quoted market prices for those or similar investments. The fair value of long-term debt obligations is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements and it approximates the carrying value.

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 501(c)(3) 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.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Physician Receivables

The Hospital periodically will loan physicians money or guarantee certain incomes to physicians to attract physicians to the Hospital's market. The income guarantees generally provide for payments to the physicians for up to two years, with contractual provisions that the advances are forgiven if the physician continues to practice in the Hospital market for three years subsequent to the income guaranty period. The loans are generally due over a five year period with varying interest rates.

The Hospital reports the income guarantees net of any forgiven amounts over the three year forgiveness period. Loans and income guarantees that are not believed to be collectible or realized have been reserved to their estimated net realizable value.

Derivatives

The Hospital uses derivatives to manage financial risks related to interest rate movements and the effects on its cash flows. The Hospital's derivative is an interest rate swap. The Hospital has not designated the interest rate swap agreement as a hedging instrument under the provisions of Statement of Financial Accounting Standards No. 133. As a result, the agreement is recorded at its fair value with subsequent changes in fair value included in earnings in the accompanying statements of revenues, expenses and changes in net assets.

Total Columns on Combined Statements

The total columns on the Combined Financial Statements for 2006 are captioned "Memorandum Only" to indicate that they are presented only to facilitate financial analysis in comparison to the current year.

New Accounting Pronouncement

In November 2005, the FASB issued FASB Staff Position No. 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners" ("FIN 45-3"). It served as an amendment to FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others" ("FIN 45") by adding minimum revenue guarantees to the list of examples of contracts to which FIN 45 applies.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Under FIN 45, a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. One example cited in FIN 45-3 involves a guarantee provided by a healthcare entity to a non-employed physician in order to recruit such physician to move to the entity's geographical area and establish a private practice, which is the approach the Hospital uses in recruiting physicians to the community. FIN 45 is effective for new minimum revenue guarantees issued or modified on or after January 1, 2006.

The Hospital adopted this amendment to FIN 45 effective January 1, 2006. For periods ending before January 1, 2006, the Hospital did not report the fair value of its obligations under physician revenue guarantee agreements. However, under FIN 45 as amended, the Hospital is required to report the liability for these physician revenue guarantees on its balance sheets at fair value and amortize the related prepaid physician recruitment expense over the period of the physician's contractual commitment to practice in the local community, which is typically three years. As of December 31, 2007 and 2006, the Hospital had not entered or modified any physician revenue guarantee agreements on or after January 1, 2006; accordingly, the adoption of this amendment had no effect on the accompanying financial statements.

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. A summary of the payment arrangements with major third-party payers follows:

Medicare – On December 30, 2005, the Hospital elected the Medicare critical access hospital (CAH) designation, which changes the payment system for the care of Medicare beneficiaries. As a CAH, inpatient and outpatient services are paid on a cost reimbursement methodology. The Hospital is reimbursed for certain services at tentative rates with a final settlement determined after submission of annual cost reports by the Hospital and audit thereof by the Medicare fiscal intermediary.

Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates. In connection with the Indiana Medicaid program, the Hospital receives additional funding through the Hospital Care for the Indigent and the Medicaid Disproportionate Share programs. These payments are received by the Hospital on a periodic basis and the Hospital estimates the revenue associated with the payments and records the difference between estimated and actual amounts in the period known.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Revenue from the Medicare and Medicaid programs accounted for approximately 42 percent and 3 percent, respectively, of the Hospital's net patient revenue for the year ended 2007, and 47 percent and 1 percent, respectively, of the Hospital's net patient revenue for the year ended 2006. 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. The following is a summary of net patient service revenue for the years ended December 31, 2007 and 2006:

	2007	2006
Patient service revenue		
Inpatient	\$ 22,647,000	\$ 20,557,842
Outpatient	49,133,924	48,347,112
Gross service patient revenue	<u>71,780,924</u>	<u>68,904,954</u>
Deductions from revenue		
Contractual allowances	30,409,176	32,958,332
Charity care	538,003	343,468
Provision for bad debts	3,407,315	2,507,337
Total deductions from revenue	<u>34,354,494</u>	<u>35,809,137</u>
Net patient service revenue	<u>\$ 37,426,430</u>	<u>\$ 33,095,817</u>

3. CHARITY CARE

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of services and supplies furnished under its charity care policy. The charity care provided during 2007 and 2006 was \$538,003 and \$343,468, respectively.

4. DEPOSITS, INVESTMENTS AND INVESTMENT INCOME

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

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Investments are carried at fair market value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Long-term investments consist of cash equivalents, certificates of deposit, mutual funds, U.S. Government securities and federally backed mortgage obligations.

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

December 31, 2007					
	Carrying amount	Investment Maturities (in Years)			
		Less than 1	1 - 5	6 - 10	More than 10
Hospital					
Certificates of Deposit	\$ 108,082	\$ 108,082	\$ -0-	\$ -0-	\$ -0-
Foundation					
Money market funds	\$ 16,729	\$ 16,729	\$ -0-	\$ -0-	\$ -0-
Mutual funds	272,719	272,719	-0-	-0-	-0-
Equities	188,334	188,334	-0-	-0-	-0-
Fixed income securities	14,532	4,998	-0-	-0-	9,534
	<u>\$ 492,314</u>	<u>\$ 482,780</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 9,534</u>

December 31, 2006					
	Carrying amount	Investment Maturities (in Years)			
		Less than 1	1 - 5	6 - 10	More than 10
Hospital					
Certificates of Deposit	\$ 102,629	\$ 102,629	\$ -0-	\$ -0-	\$ -0-
Foundation					
Money market funds	\$ 20,345	\$ 20,345	\$ -0-	\$ -0-	\$ -0-
Mutual funds	242,975	242,975	-0-	-0-	-0-
Equities	180,117	180,117	-0-	-0-	-0-
Fixed income securities	15,018	4,951	-0-	-0-	10,067
	<u>\$ 458,455</u>	<u>\$ 448,388</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 10,067</u>

Interest rate risk - The Hospital does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

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

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

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

Hospital	2007	2006
Carrying amount		
Deposits	\$ 3,104,791	\$ 1,441,676
Investments	108,082	102,629
	<u>\$ 3,212,873</u>	<u>\$ 1,544,305</u>
Included in the following balance sheet captions		
Cash and cash equivalents	\$ 3,104,791	\$ 1,441,676
Board designated funds	108,082	102,629
	<u>\$ 3,212,873</u>	<u>\$ 1,544,305</u>
Foundation		
Carrying amount		
Deposits	\$ 15,580	\$ 13,309
Investments	492,314	458,455
	<u>\$ 507,894</u>	<u>\$ 471,764</u>
Included in the following balance sheet captions		
Cash and cash equivalents	\$ 15,580	\$ 13,309
Investments	492,314	458,455
	<u>\$ 507,894</u>	<u>\$ 471,764</u>

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

5. ACCOUNTS RECEIVABLE AND PAYABLE

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at December 31, 2007 and 2006, consisted of the following amounts:

	<u>2007</u>	<u>2006</u>
<u>Patient accounts receivable</u>		
Hospital		
Receivable from patients and their insurance carriers	\$ 11,238,290	\$ 9,725,565
Receivable from Medicare	3,614,510	3,785,455
Receivable from Medicaid	<u>2,006,552</u>	<u>1,940,533</u>
Total patient accounts receivable	16,859,352	15,451,553
Less allowance for contractual agreements and uncollectible amounts	<u>9,745,436</u>	<u>9,358,568</u>
Patient accounts receivable, net	<u>\$ 7,113,916</u>	<u>\$ 6,092,985</u>
<u>Accounts payable and accrued expenses</u>		
Hospital		
Payable to suppliers and other	\$ 3,583,701	\$ 2,560,472
Payable to employees (including payroll taxes and benefits)	1,400,355	1,299,605
Other payables	<u>451,863</u>	<u>18,785</u>
Total accounts payable and accrued expenses	<u>\$ 5,435,919</u>	<u>\$ 3,878,862</u>
Foundation		
Payable to suppliers	<u>\$ 11,257</u>	<u>\$ 8,035</u>

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

6. CAPITAL ASSETS

A summary of capital assets at December 31, 2007 and 2006 is as follows:

	Balance December 31, 2006	Additions	Retirements & Transfers	Balance December 31, 2007
Hospital				
Land	\$ 750,982	\$ -0-	\$ -0-	\$ 750,982
Land improvements	817,853	7,902	-0-	825,755
Buildings and improvements	26,153,375	34,111	106,000	26,293,486
Equipment	28,641,409	583,631	-0-	29,225,040
Construction in progress	315,798	192,889	(106,000)	402,687
Total capital assets	56,679,417	818,533	-0-	57,497,950
Less accumulated depreciation				
Land improvements	613,042	24,159	-0-	637,201
Buildings and improvements	12,172,453	791,569	-0-	12,964,022
Equipment	22,529,397	1,956,334	-0-	24,485,731
Total accumulated depreciation	35,314,892	2,772,062	-0-	38,086,954
Hospital capital assets, net	<u>\$ 21,364,525</u>	<u>\$ (1,953,529)</u>	<u>\$ -0-</u>	<u>\$ 19,410,996</u>
	Balance December 31, 2005	Additions	Retirements & Transfers	Balance December 31, 2006
Hospital				
Land	\$ 750,982	\$ -0-	\$ -0-	\$ 750,982
Land improvements	812,147	5,706	-0-	817,853
Buildings and improvements	25,101,199	224,088	828,088	26,153,375
Equipment	27,528,518	931,292	181,599	28,641,409
Construction in progress	337,928	1,709,512	(1,731,642)	315,798
Total capital assets	54,530,774	2,870,598	(721,955)	56,679,417
Less accumulated depreciation				
Land improvements	581,891	31,151	-0-	613,042
Buildings and improvements	11,386,710	785,743	-0-	12,172,453
Equipment	20,620,804	2,483,203	(574,610)	22,529,397
Total accumulated depreciation	32,589,405	3,300,097	(574,610)	35,314,892
Hospital capital assets, net	<u>\$ 21,941,369</u>	<u>\$ (429,499)</u>	<u>\$ (147,345)</u>	<u>\$ 21,364,525</u>

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

7. NOTE PAYABLE

The Hospital periodically borrows funds from banks to finance certain operating expenses. The note payable bears interest at 8.25%, is unsecured and matures February 1, 2009. The following is a summary of the short-term note payable to bank activity for the years ended December 31, 2007 and 2006:

	Balance December 31, 2006	Additional Borrowings	Payments	Balance December 31, 2007
Note payable	\$ 120,479	\$ 578,220	\$ 200,000	\$ 498,699

	Balance December 31, 2005	Additional Borrowings	Payments	Balance December 31, 2006
Note payable	\$ 175,438	\$ 474,913	\$ 529,872	\$ 120,479

8. LONG-TERM OBLIGATIONS

The following is a summary of long-term obligation transactions for the Hospital for the years ended December 31, 2007 and 2006:

	Balance December 31, 2006	Additional Borrowings	Payments	Balance December 31, 2007	Current Portion	Total Long-Term Debt
Revenue bonds payable	\$ 7,515,000	\$ -0-	\$ 310,000	\$ 7,205,000	7,205,000	\$ -0-
Capital lease obligations	1,136,286	287,973	357,868	1,066,391	391,528	674,863
	<u>\$ 8,651,286</u>	<u>\$ 287,973</u>	<u>\$ 667,868</u>	<u>\$ 8,271,391</u>	<u>\$ 7,596,528</u>	<u>\$ 674,863</u>

	Balance December 31, 2005	Additional Borrowings	Payments	Balance December 31, 2006	Current Portion	Total Long-Term Debt
Revenue bonds payable	\$ 7,815,000	\$ -0-	\$ 300,000	\$ 7,515,000	7,515,000	\$ -0-
Capital lease obligations	285,073	1,078,333	227,120	1,136,286	353,723	782,563
	<u>\$ 8,100,073</u>	<u>\$ 1,078,333</u>	<u>\$ 527,120</u>	<u>\$ 8,651,286</u>	<u>\$ 7,868,723</u>	<u>\$ 782,563</u>

Revenue Bonds Payable

The bonds payable consist of health facility bonds in an original amount of \$8,365,000 dated November 18, 2003. Interest is due monthly at a defined weekly variable rate (3.50% at December 31, 2007) and the bond payments are made annually on November 1. The Hospital has entered into an interest rate swap, which is more fully described in Note 9. The bonds are secured by an irrevocable letter of credit dated November 19, 2003, which expired in 2008.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

The Letter of Credit requires the Hospital to maintain certain financial covenants such as, an unrestricted liquidity position, debt service coverage ratio and a minimum tangible net worth. The Hospital was in violation of these covenants at December 31, 2007 and 2006, and the holder of the letter of credit has not formally waived non-compliance with the covenants (Note 17).

The bondholders have the right to demand payment on the bonds upon repricing of the bonds, which can occur weekly. In the event the bondholders demand payment and the bonds are not successfully remarketed, the letter of credit secures the bondholder and the remarketer. The letter of credit is due on demand, as such; the bonds payable are reported as a current liability.

Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. The capital lease obligations have varying imputed interest rates of 2.1% to 10%, expiring through November 2012. Capital leases are collateralized by leased equipment with a cost of approximately \$1.6 million and \$1.4 million at December 31, 2007 and 2006, respectively. Accumulated depreciation on capital leases was approximately \$494,000, and \$215,000 at December 31, 2007 and 2006, respectively.

The full amount of the bonds payable is reported in current liabilities on the combined balance sheets due to the non-waiver of the loan covenants by the holder of the letter of credit. However, this disclosure is presented as if the bonds were due over the regular payment schedule. Scheduled principal and interest repayments on long-term debt and payments on capital lease obligations are as follows.

Year Ending December 31,	Long-term Debt		Capital Lease Obligations	
	Principal	Interest	Principal	Interest
2008	\$ 325,000	\$ 213,965	\$ 391,528	\$ 53,951
2009	340,000	204,313	256,227	32,849
2010	355,000	194,216	219,142	18,664
2011	370,000	183,674	140,253	6,114
2012	385,000	172,686	59,241	1,738
2013-2017	2,170,000	682,579	-0-	-0-
2018-2022	2,660,000	332,454	-0-	-0-
2023-2027	600,000	17,818	-0-	-0-
	<u>\$ 7,205,000</u>	<u>\$ 2,001,705</u>	<u>\$ 1,066,391</u>	<u>\$ 113,316</u>

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

9. INTEREST RATE SWAP AGREEMENT

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 a "cash flow hedge interest rate swap" agreement for its long-term note payable to bank. The intention of the swap is to effectively change the Hospital's variable interest rate on this note to a synthetic fixed rate of 2.893%.

Under the interest rate swap, the Hospital receives interest from the counterparty at the BMA rate and pays to the counterparty at a fixed rate of 2.893% on the notional amounts. The Hospital pays or receives the net interest amount monthly with the monthly settlements included in interest expense. The interest rate swap may be terminated by the Hospital upon 30 days written notice to the counterparty. The Hospital records the changes in fair value of the interest rate swap in nonoperating expenses. The fair value of the interest rate swap approximates \$(991) and \$53,040 at December 31, 2007 and 2006, respectively.

The agreement was entered into on February 11, 2004, and is scheduled to end February 1, 2009, and required no initial net cash receipt or payment by the Hospital. The notional amount of the swap declines by a corresponding amount each time a principal payment becomes due on the associated debt until the notional amount reaches \$2,515,000 at the termination of the swap.

10. 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. Employer contributions to the plan were \$471,569 and \$502,486 for 2007 and 2006, respectively.

11. COMMITMENTS AND CONTINGENCIES

Operating leases - lessee

The Hospital is committed under a noncancelable operating lease for equipment. The lease expires June 30, 2009. Total rent expense for 2007 and 2006 was \$302,346 and \$294,033, respectively.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

The following is a schedule of future minimum lease payments under operating leases as of December 31, 2007, that have initial or remaining lease terms in excess of one year:

Year ending December 31,	
2008	\$ 111,857
2009	<u>46,607</u>
	<u>\$ 158,464</u>

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may 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, allegation 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 legal counsel, management records an estimate of the amount of ultimate expected loss. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

12. CONCENTRATION OF CREDIT RISK

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

	2007	2006
Medicaid	13%	13%
Medicare	24%	26%
Blue Cross	10%	11%
Self pay	37%	35%
Other	16%	15%
	<u>100%</u>	<u>100%</u>

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

13. EMPLOYEE HEALTH PLAN

During 2006, the Hospital began participation in a self-funded health plan covering substantially all employees. Covered services include medical benefits. The plan has annual reinsurance coverage for individual claims in excess of \$50,000 per year with an aggregate maximum of approximately \$1,000,000. Employee health insurance benefit expense was \$1,771,233 and \$1,261,265 for 2007 and 2006, respectively. Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

14. MALPRACTICE COVERAGE

The State of Indiana puts a judgment cap of \$1,250,000 on malpractice claims for those institutions and individual physicians willing to participate in the state funded insurance "pool". The "pool" requires that an institution/physician be responsible for the first \$250,000 of every claim and the state will fund the remaining balance of each claim. In addition to the above, the state also requires that each individual physician carry a policy year aggregate limit of \$750,000 and the institution (based upon size) carry a \$5,000,000 policy year aggregate limit.

The Hospital has eliminated its risk by purchasing an insurance policy that covers all claims for the required \$250,000 occurrence limit and the \$5,000,000 statutory aggregate limit for the institution and a \$250,000 occurrence and \$750,000 statutory aggregate limit for each scheduled physician. In addition to the above limits, the insurance policy also provides an umbrella professional liability limit of \$1,000,000 that pays any claim over the initial \$250,000 for any instances in which the state funded insurance pool does not cover the claim.

15. DISCONTINUED OPERATIONS

On April 30, 2006, the Hospital sold its Renal Dialysis business line for \$2,900,000. The sale resulted in a gain of approximately \$2,750,000. The assets held for sale had a net book value of approximately \$150,000, which primarily consisted of equipment. Operating results and the gain on disposition is included in the income from operations of the discontinued component line of the combined statements of revenues, expenses and changes in nets assets.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

16. MANAGEMENT'S CONSIDERATION OF GOING CONCERN

The Hospital has experienced significant operating losses during the years ended December 31, 2007 and 2006, as well as a current ratio of 1:1. The Hospital is also in violation of certain loan covenants (Note 8 and 17).

The Hospital elected to convert to a Critical Access Hospital on December 30, 2005, to take advantage of enhanced reimbursement from the Medicare Program. Management will continue to explore additional options for enhancing reimbursement from both the Medicare and Medicaid Programs and ensure that payments due from these Programs are realized. Strategic price increases were implemented on July 1, 2006 and were designed to enhance reimbursement from commercial insurance carriers. Additionally, several managed care contracts have been negotiated during the first half of 2007 that will provide additional net patient service revenue.

Management is actively seeking options to refinance the Revenue Bonds (Note 8 and 17).

17. SUBSEQUENT EVENT

Subsequent to December 31, 2007 the Trustee drew on the Letter of Credit from the Letter of Credit Bank (the Bank), in payment of the entire outstanding principal and interest of the Bonds (Note 8), in the approximate amount of \$7,240,000 due to certain covenant violations. In relation thereto, a Forbearance Agreement was effective November 3, 2008 and now requires the Hospital to hold \$3,700,000 in a Restricted Cash account during the Forbearance period, which ends on the date that is the earlier of the date of certain Termination Event(s) as are defined within the agreement, or April 1, 2009, or such later date to which the Agreement may be extended by the Bank. The Hospital paid \$55,000 to the Bank in consideration of the Forbearance Agreement and legal fees incurred by the Bank and is also required to reimburse the Bank for any fees and expenses incurred related to the Agreement. The Reimbursement and Pledge Agreement dated as of November 1, 2003 pursuant to which the Bank issued its Irrevocable Direct Pay Letter of Credit dated November 19, 2003, issued for the benefit of the trustee was paid in full by the Bank. The related Reimbursement Obligation due from the Hospital to the Bank accrues interest at a per annum rate equal to the Bank's Prime Rate plus five percent from the date of the last drawing under the Letter of Credit until paid in full. Accrued interest shall be due and payable to the Bank on the first business day of each calendar month commencing on December 1, 2008. Other conditions, covenants and terms apply.

The Hospital entered into a Confidentiality and Standstill Agreement during January 2009 with a healthcare system with respect to a merger/acquisition. Representatives from the healthcare system have communicated their intention to request approval to enter into a Letter of Intent with Dunn Memorial Hospital.