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302 WEST WASHINGTON STREET
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INDIANAPOLIS, INDIANA 46204-2765

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

July 20, 2010

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

We have reviewed the audit report prepared by Blue & Co., LLC, Independent Public Accountants, for the period January 1, 2009 to December 31, 2009. 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 Morgan Hospital and Medical Center, as of December 31, 2009, and the results of its operations for the period then ended, on the basis of accounting described in the report.

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

STATE BOARD OF ACCOUNTS

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

CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2009 AND 2008

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

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Blue & Co., LLC / 2650 Eastpoint Parkway, Suite 300 / Louisville, KY 40223
main 502.992.3500 fax 502.992.3509 email blue@blueandco.com

blueandco.com

REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Morgan Hospital and Medical Center
Martinsville, Indiana

We have audited the accompanying consolidated balance sheets of Morgan Hospital and Medical Center and Affiliated Organizations (the "Medical Center"), component units of Morgan County, as of December 31, 2009 and 2008, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of December 31, 2009 and 2008, and the results of its operations and changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

Blue & Co., LLC

April 21, 2010

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

Management's discussion and analysis of Morgan Hospital and Medical Center and Affiliated Organizations (the "Medical Center") presents information concerning the financial performance during the years ended December 31, 2009 and 2008. This management discussion and analysis includes the activities and results of Morgan Hospital and Medical Center (the "Hospital") and its related entities, which are included in the Consolidated Financial Statements of the Hospital.

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

FINANCIAL HIGHLIGHTS

The Medical Center's net assets increased \$2,689,317 from 2008 to 2009 which includes income from operations of \$1,029,103 and non-operating income of \$1,660,214.

- For the year ended December 31, 2009, the Medical Center's total operating revenues decreased 9.7% to \$49,334,161 and expenses decreased 8.2% to \$48,305,058. Income from operations decreased \$971,327 to \$1,029,103. The decrease in income from operations can be attributed to lower volumes. Adjusted patient days decreased 2.6% from 24,895 to 24,247 and occupancy percentage decreased from 21.8% to 17.9%. In addition, Medicaid Disproportionate Share ("DSH") and Upper Payment Limit ("UPL") payments decreased \$2,308,499 from 2008 to 2009.
- During 2009, the revenues in Laboratory increased by \$1,392,531, Radiology Services by \$1,119,062, Bridges by \$1,088,169, Surgical Services \$736,072, and ICU/CCU by \$660,436.

FINANCIAL STATEMENTS

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2009 AND 2008

operating activities, capital and related financing activities, and investing activities, plus provide information on the sources and uses of cash during both the current and prior year.

FINANCIAL ANALYSIS

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

A summary of the Medical Center's Consolidated Balance Sheets as of December 31, 2009 and 2008, is presented below:

	2009	2008	\$ Change	% Change
Cash and investments	\$ 21,253,899	\$ 17,727,540	\$ 3,526,359	19.9%
Capital assets	20,692,293	22,579,437	(1,887,144)	-8.4%
Other assets	7,457,041	8,761,198	(1,304,157)	-14.9%
Total assets	<u>\$ 49,403,233</u>	<u>\$ 49,068,175</u>	<u>\$ 335,058</u>	0.7%
Long-term debt, including current portion	\$ 14,507,184	\$ 16,133,372	\$ (1,626,188)	-10.1%
Other current and noncurrent liabilities	6,210,985	6,939,056	(728,071)	-10.5%
Total liabilities	20,718,169	23,072,428	(2,354,259)	-10.2%
Net assets				
Investment in capital assets net of related debt	6,185,109	6,446,065	(260,956)	-4.0%
Restricted for donor-designated purposes	670,626	577,626	93,000	16.1%
Unrestricted	21,829,329	18,972,056	2,857,273	15.1%
Total net assets	<u>28,685,064</u>	<u>25,995,747</u>	<u>2,689,317</u>	10.3%
Total liabilities and net assets	<u>\$ 49,403,233</u>	<u>\$ 49,068,175</u>	<u>\$ 335,058</u>	0.7%

As can be seen from the table above, net assets increased in 2009 to \$28,685,064. The change in net assets resulted from income from operations of \$1,029,103 and non-operating income of \$1,660,214, of which \$1,079,996 was interest expense, \$1,666,288 was investment income, \$1,029,028 was the positive change in value of interest rate swaps, and the remainder was from contribution income and other expenses.

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2009 AND 2008**

A summary of the Medical Center's Consolidated Statements of Operations for the years ended December 31, 2009 and 2008, is presented below:

	<u>2009</u>	<u>2008</u>	<u>\$ Change</u>	<u>% Change</u>
Operating revenues				
Net patient service revenue	\$ 48,777,975	\$ 54,216,667	\$ (5,438,692)	-10.0%
Other revenue	<u>556,186</u>	<u>446,879</u>	<u>109,307</u>	24.5%
Total operating revenues	49,334,161	54,663,546	(5,329,385)	-9.7%
Operating expenses				
Salaries and benefits	27,101,330	30,589,862	(3,488,532)	-11.4%
Supplies and other	18,099,828	18,562,744	(462,916)	-2.5%
Depreciation and amortization	<u>3,103,900</u>	<u>3,469,798</u>	<u>(365,898)</u>	-10.5%
Total operating expenses	<u>48,305,058</u>	<u>52,622,404</u>	<u>(4,317,346)</u>	-8.2%
Income (loss) from operations	1,029,103	2,041,142	(1,012,039)	-49.6%
Nonoperating revenues (expenses)	<u>1,660,214</u>	<u>(4,153,558)</u>	<u>5,813,772</u>	140.0%
Change in net assets	<u>\$ 2,689,317</u>	<u>\$ (2,112,416)</u>	<u>\$ 4,801,733</u>	227.3%
Net assets, end of year	<u>\$ 28,685,064</u>	<u>\$ 25,995,747</u>	<u>\$ 2,689,317</u>	10.3%

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

FINANCIAL ANALYSIS – CASH FLOWS

The Medical Center's cash flows decreased \$1,585,990 due mostly to a decrease in cash received for patient services, noncapital contributions, principal payments on long-term debt, interest expense, and changes in assets whose use is limited.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2009 AND 2008

SOURCES OF REVENUE

During the year ended December 31, 2009, the Medical Center derived substantially all of its revenues from patient services and other related activities. Revenues include, among other items, revenues from the Medicare and Medicaid programs, insurance carriers, and patients. The table below presents the percentage of gross revenue for patient services, by payor, for the years ended December 31, 2009 and 2008.

<u>Payor Mix</u>	<u>2009</u>	<u>2008</u>
Medicare	39.0 %	39.1 %
Medicaid	20.7	15.3
Blue Cross	16.8	15.9
Other third-party payors	16.7	22.9
Self-pay	<u>6.8</u>	<u>6.8</u>
Total	<u>100.0 %</u>	<u>100.0 %</u>

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

OPERATING AND FINANCIAL PERFORMANCE

Overall, the Medical Center's financial performance from operations declined in 2009 compared to 2008. This section will discuss highlights of 2009 operations and changes in activity.

Revenues

Net patient service revenues decreased 10.0% in 2009 primarily as a result of a decrease in volumes. Further discussion follows:

- Inpatient activity levels for all units except the nursery, as measured by admissions, decreased by 318, or 14.0%. Total patient days (excluding nursery) decreased to 8,054, a decrease of 9.2%. The decrease was attributable to a decrease in patient admissions and length of stay in all inpatient units. The decreased admissions are partly attributed to the loss of physicians and an industry trend toward less inpatient utilization.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

- Outpatient activity levels as measured by visits/registrations decreased 6.1% for the Hospital and 0.3% MPS and MHS.
- The provision for bad debts as a percentage of gross revenue increased from 6.3% in 2008 to 7.0% in 2009. The Medical Center's provision for bad debts continues to remain high compared to other communities due to the economy in the region, higher deductibles and co-pays, and the increased number of uninsured patients.

Expenses

Total operating expenses decreased by 8.2% or \$4,317,346. Further discussion follows:

- Salaries and benefits decreased \$3,488,532 or 11.4% as a result of a freeze on merit increases, replacement of contract labor with permanent staff, and a decrease in healthcare claims between years.
- Supplies and other expenses decreased \$462,916 or 2.5% as a result of decreased volumes.
- Depreciation and amortization expense decreased \$365,898 or 10.5% due to an increasing number of fully depreciated assets.

Capital Assets

During 2009, the Medical Center purchased \$1,195,994 of capital assets and retired \$114,001 of capital assets for a net increase of \$1,081,993 as outlined in the table below:

	2009	2008	\$Change	%Change
Land and land improvements	\$ 2,468,572	\$ 2,252,572	\$ 216,000	9.6%
Buildings	22,615,925	22,549,914	66,011	0.3%
Equipment	39,140,297	38,286,760	853,537	2.2%
Construction in progress	55,418	108,973	(53,555)	-49.1%
	64,280,212	63,198,219	1,081,993	1.7%
Less accumulated depreciation	(43,587,919)	(40,618,782)	(2,969,137)	7.3%
Capital assets, net	\$ 20,692,293	\$ 22,579,437	\$ (1,887,144)	-8.4%

Gross capital assets have increased due to the purchase of land; remodeling of the physical therapy clinic, the purchase of a new mammography system for the women's life services unit, and a variety of upgrades to the facility itself.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2009 AND 2008

The Medical Center budgeted \$3,000,000 for 2009 capital expenditures but only had purchases of \$1,195,994. The positive variance from actual of \$1,804,006 was primarily due to a concerted effort to only spend capital dollars on essential needs.

Long-Term Debt

At the end of the 2009 fiscal year, the Medical Center had long-term debt (including current portion) of \$14,507,184. Included in this amount is \$12,045,000 of bonds payable that are secured by a letter of credit with a bank. The bank's letter of credit securing the bonds will expire in December 2011, unless extended or earlier terminated.

ECONOMIC FACTORS AND 2010 BUDGET

The Medical Center's Board and management considered many factors when establishing the 2010 Budget. Included was the status of the economy, which takes into account market factors and other environmental factors such as the following items:

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

CONTACTING THE MEDICAL CENTER'S CHIEF FINANCIAL OFFICER

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

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

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2009 AND 2008

ASSETS

	2009	2008
Current assets		
Cash and cash equivalents	\$ 6,121,977	\$ 4,442,225
Certificates of deposit	2,459,337	2,385,455
Patient accounts receivable, net of estimated uncollectibles of \$7,219,590 in 2009 and \$6,024,478 in 2008	5,768,795	6,930,649
Inventories	922,024	1,049,351
Prepaid expenses and other current assets	459,902	429,428
Other assets, current portion	10,187	10,737
Current portion of assets whose use is limited	11,154,959	9,596,234
Total current assets	26,897,181	24,844,079
 Assets whose use is limited, net of amount required to meet current obligations	 1,517,626	 1,303,626
 Capital assets		
Land	1,913,186	1,697,186
Land improvements	555,386	555,386
Buildings	22,615,925	22,549,914
Fixed equipment	5,660,892	5,662,332
Movable equipment	33,479,405	32,624,428
	64,224,794	63,089,246
Less accumulated depreciation	43,587,919	40,618,782
	20,636,875	22,470,464
Construction in progress	55,418	108,973
Capital assets, net	20,692,293	22,579,437
 Other assets, net of current portion	 296,133	 341,033
 Total assets	 \$ 49,403,233	 \$ 49,068,175

See accompanying notes to consolidated financial statements.

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

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2009 AND 2008

LIABILITIES AND NET ASSETS

	2009	2008
Current liabilities		
Accounts payable	\$ 1,795,663	\$ 1,643,673
Accrued payroll and payroll withholdings	685,245	788,402
Accrued expenses	1,162,148	1,456,024
Estimated third-party payor settlements	450,000	25,000
Current portion of obligations under capital leases	1,191,511	1,763,357
Current portion of long-term debt	12,046,620	12,356,536
Total current liabilities	17,331,187	18,032,992
 Long-term liabilities		
Obligations under capital leases, net of current portion	952,590	1,803,951
Long-term debt, net of current portion	316,463	209,528
Interest rate swaps	1,270,929	2,299,957
Other	847,000	726,000
Total long-term liabilities	3,386,982	5,039,436
 Total liabilities	20,718,169	23,072,428
 Net assets		
Invested in capital assets net of related debt	6,185,109	6,446,065
Restricted		
Expendable for donor-designated purposes	670,626	577,626
Unrestricted	21,829,329	18,972,056
Total net assets	28,685,064	25,995,747
 Total liabilities and net assets	\$ 49,403,233	\$ 49,068,175

See accompanying notes to consolidated financial statements.

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

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
Operating revenues		
Net patient service revenue	\$ 48,777,975	\$ 54,216,667
Other revenue	556,186	446,879
Total operating revenues	49,334,161	54,663,546
Operating expenses		
Salaries and wages	21,704,056	23,420,899
Employee benefits and payroll taxes	5,397,274	7,168,963
Professional medical fees	1,289,984	1,261,624
Medical supplies	3,267,163	3,113,557
Other supplies	755,489	877,143
Drugs	2,881,655	2,941,531
Purchased services	5,985,515	6,110,389
Utilities	1,113,936	1,206,931
Insurance	789,855	722,933
Depreciation and amortization	3,103,900	3,469,798
Rent	724,695	661,904
Other operating expenses	1,291,536	1,666,732
Total operating expenses	48,305,058	52,622,404
Income from operations	1,029,103	2,041,142
Nonoperating revenues (expenses)	1,660,214	(4,153,558)
Excess revenues (expenses)/		
Change in net assets	2,689,317	(2,112,416)
Net assets, beginning of year	25,995,747	28,108,163
Net assets, end of year	\$ 28,685,064	\$ 25,995,747

See accompanying notes to consolidated financial statements.

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2009 AND 2008**

	2009	2008
Operating activities		
Cash received for patient services	\$ 50,364,829	\$ 55,029,707
Cash paid to/for employees	(27,204,487)	(31,108,844)
Cash paid to vendors and suppliers	(18,124,360)	(18,502,825)
Other receipts, net	556,186	446,879
Net cash flows from operating activities	5,592,168	5,864,917
Noncapital financing activities		
Noncapital contributions	160,687	669,344
Capital and related financing activities		
Principal payments on obligations under capital leases	(1,763,207)	(1,949,842)
Principal payments on long-term debt	(710,377)	(485,000)
Interest paid	(1,100,497)	(889,225)
Purchases of capital assets	(855,994)	(824,444)
Change in bond discount	6,896	6,894
Borrowings on long-term debt	500,500	-0-
Loss on disposal of capital assets	3,033	3,395
Net cash flows from capital and related financing activities	(3,919,646)	(4,138,222)
Investing activities		
Investment income	2,695,316	(3,718,854)
Change in certificates of deposit	(73,882)	(116,039)
Change in assets whose use is limited	(5,159,467)	4,529,186
Other nonoperating revenues (expenses)	(115,793)	(185,104)
Change in interest rate swaps	(1,029,028)	1,529,277
Change in other long-term liabilities	121,000	121,000
Change in other assets	21,655	2,678
Net cash flows from investing activities	(3,540,199)	2,162,144
 Net change in cash and cash equivalents	 (1,706,990)	 4,558,183
Cash and cash equivalents, beginning of year	9,727,139	5,168,956
Cash and cash equivalents, end of year	\$ 8,020,149	\$ 9,727,139
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents in current assets	\$ 6,121,977	\$ 4,442,225
Cash and cash equivalents in assets whose use is limited	1,898,172	5,284,914
 Total cash and cash equivalents	 \$ 8,020,149	 \$ 9,727,139

See accompanying notes to consolidated financial statements.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
Reconciliation of income from operations to net cash and cash equivalents from operating activities		
Income from operations	\$ 1,029,103	\$ 2,041,142
Adjustments to reconcile income from operations to net cash flows from operating activities		
Depreciation	3,080,105	3,446,003
Amortization	23,795	23,795
Provision for bad debts	10,507,174	9,802,628
Changes in operating assets and liabilities		
Patient accounts receivable	(9,345,320)	(9,314,588)
Inventories	127,327	52,809
Prepaid expenses and other current assets	(30,474)	423,118
Accounts payable	151,990	(158,290)
Accrued payroll and payroll withholdings	(103,157)	(518,982)
Accrued expenses	(273,375)	(257,718)
Estimated third party payor settlements	425,000	325,000
Net cash flows from operating activities	\$ 5,592,168	\$ 5,864,917
 Supplemental disclosures of noncash capital and related financing activities		
Capital assets acquired included in accounts payable	\$ -0-	\$ 79,018
Capital assets acquired under capital leases	\$ 340,000	\$ 57,980

See accompanying notes to consolidated financial statements.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

1. NATURE OF OPERATIONS

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

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

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

Morgan County Memorial Hospital Foundation, Inc. (the "Foundation") is a not-for-profit organization located in Martinsville, Indiana. The Foundation operates for the benefit of the Hospital, and is a blended component unit of the Hospital. The Foundation's primary source of support is from contributions received.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Reporting Entity and Consolidation Policy

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

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

The separate financial statements of MHS, MPS, and the Foundation may be obtained through contacting the Hospital as follows:

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

Management's Estimates

Management uses estimates and assumptions in preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if any, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Proprietary Fund Accounting

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

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) standards, the Medical Center has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Risk Management

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

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Cash and Cash Equivalents

Cash and cash equivalents as reported on the consolidated balance sheets include petty cash and other cash on hand amounts, checking accounts, and savings accounts that are readily available for use, excluding amounts included in assets whose use is limited.

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

Patient Accounts Receivable and Net Patient Service Revenue

Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including the estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are estimated and accrued in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Allowance for Patient Uncollectible Accounts

The Medical Center estimates an allowance for uncollectible patient accounts receivable based on an evaluation of the aging of the accounts, historical losses, current economic conditions, and other factors unique to their service area and the healthcare industry.

Inventories

Inventories consist of medical supplies, pharmaceuticals, and office supplies and are valued at the lower of cost or market, with cost being determined on the first-in, first-out (FIFO) method.

Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the Hospital's Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes; assets that have been restricted by donors for specific purposes; and insurance benefit plan assets related to an executive deferred compensation agreement.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair market value in the consolidated balance sheets. Investment income or loss, including realized gains and losses on

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

Capital Assets

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

Costs of Borrowing

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

Other Assets

Other assets consist of notes receivable, bond issues costs, and goodwill relating to the purchase of physician practices. Bond issue costs are being amortized over the lives of the bonds on the straight-line method, and goodwill is being amortized over a 5-year period using the straight-line method.

Net Assets

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

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Consolidated Statements of Operations and Changes in Net Assets

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

Performance Indicator

The Consolidated Statements of Operations and Changes in Net Assets include *excess revenues (expenses)*. Consistent with industry practice, changes in unrestricted net assets which are excluded from *excess revenues (expenses)* include, if any, permanent transfers of assets to and from affiliates for other than goods and services and contributions of long-lived assets.

Charity Care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are reported as reductions in net patient service revenue.

Advertising and Public Relations Costs

Advertising and public relations costs are charged to operations when incurred. Advertising and public relations costs charged to operations were \$501,410 and \$637,197 for the years ended December 31, 2009 and 2008, respectively.

Income Taxes

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

Grants and Contributions

From time to time, the Medical Center receives grants as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all

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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 within nonoperating revenues (expenses). Amounts restricted to capital acquisitions are reported after nonoperating revenues (expenses).

Reclassifications

Certain 2008 amounts have been reclassified to provide for consistency with reporting of 2009 information. These reclassifications have no effect on the previously reported change in net assets or net assets.

Subsequent Events

The Medical Center has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is April 21, 2010.

3. BANK DEPOSITS AND INVESTMENTS

Deposits and investments are comprised of the following at December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Carrying amount		
Cash and cash equivalents	\$ 8,020,149	\$ 9,727,139
Certificates of deposit	2,642,826	2,564,884
Mutual funds	9,100,924	4,159,517
Cash surrender value of life insurance	<u>847,000</u>	<u>726,000</u>
Total	<u>\$ 20,610,899</u>	<u>\$ 17,177,540</u>
Included in the consolidated balance sheet captions:		
Cash and cash equivalents	\$ 6,121,977	\$ 4,442,225
Certificates of deposit	2,459,337	2,385,455
Assets whose use is limited	<u>12,029,585</u>	<u>10,349,860</u>
Total	<u>\$ 20,610,899</u>	<u>\$ 17,177,540</u>

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Custodial Credit Risk – Deposits

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

Investments are carried at fair market value or cost which approximates fair value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. As of December 31, 2009 and 2008, the Medical Center had the following investments and maturities, all of which were held in the Medical Center's name by custodial banks or investment companies that are agents of the Medical Center:

	December 31, 2009				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
Certificates of deposit	\$ 2,642,826	\$ 2,642,826	\$ -0-	\$ -0-	\$ -0-

	December 31, 2008				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
Certificates of deposit	\$ 2,564,884	\$ 2,564,884	\$ -0-	\$ -0-	\$ -0-

Interest Rate Risk

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

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

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Credit Risk – Investments

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

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

Concentration of Credit Risk

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

4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable reported as current assets at December 31, 2009 and 2008, consist of the following:

	<u>2009</u>	<u>2008</u>
Receivable from Medicare	\$ 5,686,179	\$ 4,676,212
Receivable from Medicaid	3,012,485	2,058,035
Receivable from Blue Cross	2,095,093	2,041,074
Receivable from other insurance carriers	3,591,476	4,440,797
Receivable from patients	<u>7,855,502</u>	<u>7,490,620</u>
Total patient accounts receivable	22,240,735	20,706,738
Less allowance for contractals	9,252,350	7,751,611
Less allowance for uncollectible amounts	<u>7,219,590</u>	<u>6,024,478</u>
 Patient accounts receivable, net	 <u>\$ 5,768,795</u>	 <u>\$ 6,930,649</u>

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5. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited that are required for obligations classified as current liabilities or are receivable within one year are reported in current assets, if any. Assets whose use is limited are reported at market value or cost which approximates fair value and include the following at December 31, 2009 and 2008:

Total Investment Summary by Class

	2009	%	2008	%
Cash and cash equivalents	\$ 1,898,172	15.0 %	\$ 5,284,914	48.5 %
Cash surrender value of life insurance	847,000	6.7	726,000	6.7
Certificates of deposit	183,489	1.4	179,429	1.6
Mutual funds	9,100,924	71.8	4,159,517	38.2
Donation receivable	643,000	5.1	550,000	5.0
Total assets whose use is limited	12,672,585	<u>100.0 %</u>	10,899,860	<u>100.0 %</u>
Less amount required for current obligations	<u>11,154,959</u>		<u>9,596,234</u>	
Assets whose use is limited, net of amount required to meet current obligations	<u>\$ 1,517,626</u>		<u>\$ 1,303,626</u>	

Total Investment Summary by Fund

	2009	%	2008	%
Board-Designated Funds	\$ 9,556,365	75.4 %	\$ 8,022,595	73.6 %
Building Fund	1,598,594	12.6	1,573,639	14.4
Donor-Restricted Funds	670,626	5.3	577,626	5.3
Insurance Benefit Plan	847,000	6.7	726,000	6.7
Total	<u>\$ 12,672,585</u>	<u>100.0 %</u>	<u>\$ 10,899,860</u>	<u>100.0 %</u>

Board-Designated Funds

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

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Building Fund

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

Insurance Benefit Plan Assets

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

Donor-Restricted Funds

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

Fair Value Measurements and Disclosures

Major classes of assets and liabilities that are measured at fair value are categorized according to a fair value hierarchy that prioritizes the inputs to value techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

Level 1 inputs are readily determinable using unadjusted quoted prices for identical assets or liabilities in active markets. Level 2 inputs are derived from quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets (other than those included in Level 1) which are observable for the asset or liability, either directly or indirectly. Level 3 inputs are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. If the inputs used fall within different levels of the hierarchy, the categorization is based upon the lowest level input that is significant to the fair value measurement.

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Assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets whose use is limited				
Cash surrender value of life insurance	\$ -0-	\$ -0-	\$ 847,000	\$ 847,000
Mutual funds	<u>9,100,924</u>	<u>-0-</u>	<u>-0-</u>	<u>9,100,924</u>
	<u>\$ 9,100,924</u>	<u>\$ -0-</u>	<u>\$ 847,000</u>	<u>\$ 9,947,924</u>
Long-term liabilities				
Interest rate swaps	<u>\$ -0-</u>	<u>\$ 1,270,929</u>	<u>\$ -0-</u>	<u>\$ 1,270,929</u>

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2008 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets whose use is limited				
Cash surrender value of life insurance	\$ -0-	\$ -0-	\$ 726,000	\$ 726,000
Mutual funds	<u>4,159,517</u>	<u>-0-</u>	<u>-0-</u>	<u>4,159,517</u>
	<u>\$ 4,159,517</u>	<u>\$ -0-</u>	<u>\$ 726,000</u>	<u>\$ 4,885,517</u>
Long-term liabilities				
Interest rate swaps	<u>\$ -0-</u>	<u>\$ 2,299,957</u>	<u>\$ -0-</u>	<u>\$ 2,299,957</u>

The following table sets forth a summary of changes in the fair values of the Medical Center's Level 3 assets for the year ended December 31, 2009:

	<u>Cash Surrender Value of Life Insurance</u>
Balance, beginning of year	\$ 726,000
Change in cash surrender value of life insurance	<u>121,000</u>
Balance, end of year	<u>\$ 847,000</u>

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The following table sets forth a summary of changes in the fair values of the Medical Center's Level 3 assets for the year ended December 31, 2008:

	Cash Surrender Value of Life Insurance
Balance, beginning of year	\$ 605,000
Change in cash surrender value of life insurance	121,000
Balance, end of year	\$ 726,000

Investments in Cash Surrender Value of Life Insurance are recorded at fair value which is based on the contract value of the insurance policies.

6. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2009 and 2008, was as follows:

	2009			
	Beginning Balance	Additions	Retirements / Transfers	Ending Balance
Land	\$ 1,697,186	\$ 216,000	\$ -0-	\$ 1,913,186
Land improvements	555,386	-0-	-0-	555,386
Buildings	22,549,914	66,011	-0-	22,615,925
Fixed equipment	5,662,332	-0-	(1,440)	5,660,892
Movable equipment	32,624,428	861,882	(6,905)	33,479,405
Construction in progress	108,973	52,101	(105,656)	55,418
Total historical cost	63,198,219	1,195,994	(114,001)	64,280,212
Less accumulated depreciation for				
Land improvements	(369,429)	(25,650)	-0-	(395,079)
Buildings	(12,152,895)	(474,021)	-0-	(12,626,916)
Fixed equipment	(4,365,522)	(157,764)	1,440	(4,521,846)
Movable equipment	(23,730,936)	(2,422,670)	109,528	(26,044,078)
Total accumulated depreciation	(40,618,782)	(3,080,105)	110,968	(43,587,919)
Capital assets, net	\$ 22,579,437	\$ (1,884,111)	\$ (3,033)	\$ 20,692,293

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	2008			
	Beginning Balance	Additions	Retirements / Transfers	Ending Balance
Land	\$ 1,697,186	\$ -0-	\$ -0-	\$ 1,697,186
Land improvements	534,142	21,244	-0-	555,386
Buildings	22,549,914	-0-	-0-	22,549,914
Fixed equipment	5,652,648	9,684	-0-	5,662,332
Movable equipment	31,439,443	742,523	442,462	32,624,428
Construction in progress	612,589	187,991	(691,607)	108,973
Total historical cost	<u>62,485,922</u>	<u>961,442</u>	<u>(249,145)</u>	<u>63,198,219</u>
Less accumulated depreciation for				
Land improvements	(342,774)	(26,655)	-0-	(369,429)
Buildings	(11,680,872)	(472,023)	-0-	(12,152,895)
Fixed equipment	(4,199,141)	(166,381)	-0-	(4,365,522)
Movable equipment	<u>(21,195,742)</u>	<u>(2,780,944)</u>	245,750	<u>(23,730,936)</u>
Total accumulated depreciation	<u>(37,418,529)</u>	<u>(3,446,003)</u>	<u>245,750</u>	<u>(40,618,782)</u>
Capital assets, net	<u>\$ 25,067,393</u>	<u>\$ (2,484,561)</u>	<u>\$ (3,395)</u>	<u>\$ 22,579,437</u>

7. COMPENSATED ABSENCES

The Hospital and MHS provide paid time off (PTO) policies to employees for vacation, personal days, and holidays. Upon employment, full and part-time employees accrue PTO from the date of hire. After completion of 30 days of service, full and part-time employees qualify for PTO with pay for the total amount accrued. The maximum number of hours that employees may carry over to the following year as of December 31st, is 208 for the Hospital and 40 for MHS.

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

Length of Service	Hospital Hours Earned Per Year	MHS Hours Earned Per Year (Date of Hire Pre-2004)	MHS Hours Earned Per Year (Date of Hire 2004 and After)
0 - 5 years	208	208	160
6 - 14 years	248	248	160
15 or more years	288	288	160

PTO days are accrued when incurred and reported as accrued expenses in the consolidated financial statements. The PTO accrual at December 31, 2009 and 2008, was \$692,421 and \$638,595, respectively.

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8. EMPLOYEE HEALTH BENEFIT PLAN

The Medical Center operates a self-funded health plan covering substantially all eligible employees. The Medical Center has an annual stop loss limit on the plan of \$120,000 per individual. The Medical Center does not carry aggregate stop loss limits. Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of pay out, and other economic and social factors.

Changes in the balances of claims liabilities during the years ended December 31, 2009 and 2008, were as follows:

	2009	2008
Accrued liability, beginning of year	\$ 494,298	\$ 356,198
Incurred claims and changes in estimates	2,655,070	4,019,593
Claim payments	(2,810,215)	(3,881,493)
Accrued liability, end of year	\$ 339,153	\$ 494,298

9. PENSION PLAN

The Medical Center sponsors separate defined contribution pension plans that cover all eligible employees who work over 1,000 hours a year. To be eligible for enrollment, employees must have completed one year of employment and be 21 years of age. The Hospital contributes for each eligible participant an amount equal to 7 percent of compensation that does not exceed 150 percent of the social security contribution. MHS annually determines the amount to contribute to their plan. This contribution is discretionary. MPS sponsors various defined contribution pension plans that cover all eligible employees (physicians) according to the terms of each physician's individual employment agreement. The Medical Center incurred expenses related to these plans of \$775,798 and \$1,122,897 for the years ended December 31, 2009 and 2008, respectively.

10. OBLIGATIONS UNDER CAPITAL LEASES

The Medical Center is the lessee of equipment under capital leases expiring in various years through 2014. The assets and liabilities under the capital lease are originally recorded at the lower of the present value of the minimum lease payments

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or the fair value of the asset. Amortization of assets held under the capital lease is included in depreciation expenses and was \$1,100,179 and \$1,447,316 for the years ended December 31, 2009 and 2008, respectively. The capital lease obligations carry imputed interest rates between 3.3 and 8.4 percent, and are collateralized by the leased equipment.

Following is a summary of equipment held under capital leases:

	2009	2008
Equipment	\$ 7,222,143	\$ 6,882,143
Less: accumulated amortization	4,330,344	3,230,165
	\$ 2,891,799	\$ 3,651,978

Capital lease activity for the years ended December 31, 2009 and 2008, was as follows:

	2009				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Obligations under capital leases	\$ 3,567,308	\$ 340,000	\$ 1,763,207	\$ 2,144,101	\$ 1,191,511

	2008				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Obligations under capital leases	\$ 5,459,170	\$ 57,980	\$ 1,949,842	\$ 3,567,308	\$ 1,763,357

Debt service requirements on obligations under capital leases at December 31, 2009, are as follows:

Year Ending December 31,	Principal	Interest
2010	\$ 1,191,511	\$ 61,499
2011	608,828	29,795
2012	186,400	8,939
2013	77,382	4,038
2014	79,980	1,440
Total	\$ 2,144,101	\$ 105,711

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11. LONG-TERM DEBT

At December 31, 2009 and 2008, the Medical Center was obligated for long-term debt agreements as follows:

	2009	2008
Economic Development Revenue Bonds, Series 2002A, dated December 17, 2002, payable in annual principal installments commencing December 1, 2003 through December 1, 2027, in amounts ranging from \$45,000 to \$95,000. Variable interest rate determined weekly (0.75% at December 31, 2009). Interest is paid in monthly installments. Secured by letter of credit from Fifth Third Bank.	\$ 1,350,000	\$ 1,405,000
Economic Development Revenue Bonds, Series 2002B, dated December 17, 2002, payable in annual principal installments commencing December 1, 2004 through December 1, 2027, in amounts ranging from \$255,000 to \$780,000. Variable interest rate determined weekly (0.75% at December 31, 2009); Interest is paid in monthly installments. Secured by letter of credit from Fifth Third Bank.	10,695,000	10,985,000
Floating Rate Demand Notes, Series 2002 - paid off in 2009.	-0-	285,000
Note payable to bank dated January 2009; monthly principal and interest payments of \$8,633 commencing March 2009 and ending February 2012. Fixed interest rate of 5.5% per annum. Secured by deposit amounts and certificates of deposit.	211,019	-0-

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Note payable to bank dated April 2009; monthly principal and interest payments of \$1,843 commencing May 2009 through April 2024. Fixed interest rate of 6.25% per annum. Secured by mortgage on Hospital property.

	209,104	-0-
Total long-term debt	12,465,123	12,675,000
Less unamortized bond discounts	(102,040)	(108,936)
Less current portion	(12,046,620)	(12,356,536)
Long-term debt, net of current portion	\$ 316,463	\$ 209,528

On December 17, 2002, Morgan County, Indiana issued \$14,030,000 of Adjustable Rate Demand Economic Development Revenue Bonds, Series 2002A and 2002B (the "Bonds") on behalf of the Medical Center. The proceeds of the Bonds were used to finance the acquisition, construction, and equipping of certain economic development facilities, including a new oncology center, a new medical office building and other capital improvements to the Medical Center; advance refund the Morgan County Hospital Association First Mortgage Revenue Refunding Bonds, Series 1993 and other loans and capital leases of the Medical Center; pay capitalized interest on the Series 2002 Bonds; and pay certain costs related to the issuance of the Series 2002 Bonds. The bank's letter of credit securing the Bonds will expire in December 2011, unless extended or earlier terminated. In the event of a "Remarketing Drawing" as defined by the bank's letter of credit, principal plus accrued interest on such Remarketing Drawing is to be paid by the Medical Center within 367 days from the Remarketing Drawing.

Interest Rate Swap Agreements

The Derivatives and Hedging Topic of the FASB Accounting Standards Codification requires companies to recognize all of their derivative instruments as either assets or liabilities. The accounting for changes in fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship.

In conjunction with the Bonds, the Medical Center purchased three separate interest swap rates (the "Swaps"), with a highly rated counterparty, having original notional amounts of \$4,000,000, \$5,000,000, and \$4,790,000. The Medical Center's use of the interest rate swaps is for interest rate exposure management purposes. At December 31, 2009 and 2008, the Swaps had notional amounts as follows:

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	2009 <u>Notional Amount</u>	2008 <u>Notional Amount</u>	<u>Maturity</u>
Swap A	\$ -0-	\$ 2,655,000	12/1/09
Swap B	5,000,000	5,000,000	5/1/15
Swap C	<u>7,045,000</u>	<u>4,735,000</u>	12/1/27
	<u>\$ 12,045,000</u>	<u>\$ 12,390,000</u>	

The Swaps are floating to fixed rate, which require the Medical Center to pay and receive as follows:

	<u>Fixed Interest Rate Paid</u>	<u>Variable Interest Rate Received</u>
Swap A	3.45%	Bond Market Association Municipal Swap Index
Swap B	3.82%	Bond Market Association Municipal Swap Index
Swap C	3.99%	67% of LIBOR

None of the Swaps has been designated as a hedge for accounting purposes. The change in fair market value of the Swaps is included as a component of investment income in nonoperating revenues (expenses). The fair value of the Swaps is reported as a long-term liability of \$1,270,929 and \$2,299,957 in the consolidated balance sheets at December 31, 2009 and 2008, respectively. See also Note 14 and Note 19 for items related to interest rate swaps.

Long-term debt activity for the years ended December 31, 2009 and 2008, was as follows:

	2009				
	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Revenue bonds, series 2002A	\$ 1,405,000	\$ -0-	\$ (55,000)	\$ 1,350,000	\$ 1,350,000
Revenue bonds, series 2002B	10,985,000	-0-	(290,000)	10,695,000	10,695,000
Floating rate demand notes	285,000	-0-	(285,000)	-0-	-0-
Note payable to bank	-0-	285,500	(74,481)	211,019	94,344
Note payable to bank	-0-	215,000	(5,896)	209,104	9,316
Bond discounts	<u>(108,936)</u>	<u>-0-</u>	<u>6,896</u>	<u>(102,040)</u>	<u>(102,040)</u>
Total long-term debt	<u>\$ 12,566,064</u>	<u>\$ 500,500</u>	<u>\$ (703,481)</u>	<u>\$ 12,363,083</u>	<u>\$ 12,046,620</u>

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	Beginning Balance	2008		Ending Balance	Current Portion
		Increases	Decreases		
Revenue bonds, series 2002A	\$ 1,460,000	\$ -0-	\$ (55,000)	\$ 1,405,000	\$ 1,405,000
Revenue bonds, series 2002B	11,270,000	-0-	(285,000)	10,985,000	10,985,000
Floating rate demand notes	430,000	-0-	(145,000)	285,000	74,314
Bond discounts	(115,830)	-0-	6,894	(108,936)	(107,778)
Total long-term debt	\$ 13,044,170	\$ -0-	\$ (478,106)	\$ 12,566,064	\$ 12,356,536

Debt service requirements on long-term debt at December 31, 2009, are as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>
2010	\$ 12,046,620	\$ 492,690
2011	109,609	16,133
2012	27,535	11,686
2013	11,233	10,889
2014	11,954	10,167
2015-2019	72,346	38,261
2020-2024	83,786	12,074
Total	\$ 12,363,083	\$ 591,900

Agreements relating to these long-term debt agreements and corresponding letters of credit contain various restrictive covenants, including covenants related to debt service coverage ratio, unrestricted liquidity position, and debt to tangible net assets ratio requirements. The Medical Center was in violation of certain of these restrictive covenants in 2009, and has not obtained a covenant violation waiver letter from Fifth Third Bank. Therefore, long term debt amounts secured by the bank letter of credit have been reported as current liabilities within the consolidated balance sheets.

12. INSURANCE BENEFIT PLAN

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

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13. NET PATIENT SERVICE REVENUE

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

- **Medicare**. The Medical Center is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Medical Center is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicare outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Medical Center's year end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from, or payable to the third-party program. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admissions are subject to an independent review by a peer review organization under contract with the Medical Center. As of December 31, 2009, the Medical Center's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2006.
- **Medicaid**. The Medical Center is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Medical Center is reimbursed for Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. There is no cost settlement for either of the inpatient or outpatient. For the years ended December 31, 2009 and 2008, the Medical Center received and recorded in net patient service revenue \$1,764,112 and \$4,072,611, respectively, relating to net Medicaid Disproportionate Share Hospital ("DSH") payments and Indiana Medicaid Municipal Hospital Upper Payment Limit ("UPL") adjustments.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

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

For the years ended December 31, 2009 and 2008, net patient service revenue was as follows:

	<u>2009</u>	<u>2008</u>
Gross patient service revenue		
Inpatient routine services	\$ 11,863,122	\$ 11,864,950
Inpatient ancillary services	24,238,959	27,859,267
Outpatient ancillary services	<u>114,381,834</u>	<u>104,144,838</u>
Total gross patient service revenue	150,483,915	143,869,055
Deductions from revenue		
Contractual allowances	90,269,899	78,135,232
Charity care	928,867	1,714,528
Bad debts	<u>10,507,174</u>	<u>9,802,628</u>
Total deductions from revenue	<u>101,705,940</u>	<u>89,652,388</u>
 Total net patient service revenue	 <u>\$ 48,777,975</u>	 <u>\$ 54,216,667</u>

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

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14. NONOPERATING REVENUES (EXPENSES)

For the years ended December 31, 2009 and 2008, nonoperating revenues (expenses) were as follows:

	2009	2008
Investment income (loss)	\$ 1,666,288	\$ (2,189,577)
Investment income (loss) - fair value change of interest rate swaps	1,029,028	(1,529,277)
Interest expense	(1,079,996)	(918,944)
Loss on disposal of capital assets	(3,033)	(3,395)
Contribution income	160,687	669,344
Other	(112,760)	(181,709)
Total nonoperating revenues (expenses)	\$ 1,660,214	\$ (4,153,558)

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

15. PROFESSIONAL LIABILITY INSURANCE

The Indiana Medical Malpractice Act, IC 34-18, provides a maximum recovery of \$250,000 for an occurrence of malpractice and \$1,250,000 for an injury or death of a patient due to an act of malpractice. The Act requires physicians to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$750,000 in the annual aggregate and hospitals to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$5,000,000 in the annual aggregate for hospitals with 100 or fewer occupied beds and \$7,500,000 for hospitals with more than 100 occupied beds. The Act also requires the Medical Center to pay a surcharge to the State Patient's Compensation Fund. This fund may be used to pay medical malpractice claims in excess of the annual aggregate amount noted above, under certain terms and conditions.

The Medical Center is insured against professional liability claims on a claims-made basis. Liabilities for incurred but not reported losses at December 31, 2009 and 2008, are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Medical Center's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the claims-made policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Medical Center intends to continue carrying such insurance. Professional liability insurance coverage is \$250,000 per occurrence and \$7,500,000 in the aggregate. In addition, the Medical Center has umbrella coverage of \$3,000,000 per occurrence and in the aggregate. Professional

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liability insurance expense for the years ended December 31, 2009 and 2008, was \$631,292 and \$543,879, respectively.

16. CONCENTRATIONS OF CREDIT RISK

The Medical Center grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements. The mix of gross revenue and receivables from patients and third-party payors at December 31, 2009 and 2008, was as follows:

	2009		2008	
	Revenues	Receivables	Revenues	Receivables
Medicare	39 %	26 %	39 %	23 %
Medicaid	21	14	15	10
Blue Cross	17	9	16	10
Other third-party payors	17	16	23	21
Patients	6	35	7	36
	100 %	100 %	100 %	100 %

17. CONTINGENCIES

There are a variety of legal proceedings and claims by others against the Medical Center in a variety of matters arising out of the conduct of the Medical Center's business. The ultimate resolution of such claims would not, in the opinion of management, have a material adverse effect on the consolidated financial statements.

18. TRANSFERS

For the years ended December 31, 2009 and 2008, MHS received transfers from the Hospital totaling \$1,742,863 and \$1,472,890, respectively. MPS received transfers from the Hospital in the amount of \$1,217,733 and \$1,473,081, for the years ended December 31, 2009 and 2008, respectively. These transfers have been eliminated in consolidation.

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19. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Cash and Cash Equivalents

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates its fair value.

Investments and Assets Whose Use is Limited

These assets are reported in the consolidated balance sheets at fair value or cost that approximates fair value. The fair value amounts are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Accounts Payable, Accrued Payroll and Payroll Withholdings, and Accrued Expenses

The carrying amounts reported in the consolidated balance sheets for accounts payable, accrued payroll and payroll withholdings, and accrued expenses approximate their fair value.

Estimated Third-Party Payor Settlements

The carrying amount reported in the consolidated balance sheets for estimated third-party payor settlements approximates its fair value.

Long-Term Debt, Obligations Under Capital Leases and Deferred Compensation Liabilities

The carrying amount and fair value reported in the consolidated balance sheets for the combined amounts of long-term debt and obligations under capital leases were \$14,507,184 and \$14,537,377, respectively, for 2009 and \$16,133,372 and \$16,147,698, respectively, for 2008. The carrying amount reported in the consolidated balance sheets for deferred compensation liabilities approximates its fair value.

Interest Rate Swaps

The carrying amount reported in the consolidated balance sheets for interest rate swaps approximates their fair value.