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AUDIT REPORT
OF

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF
HARRISON COUNTY, INDIANA

January 1, 2009 to December 31, 2009



FILED
10/22/2010

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HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Chief Executive Officer	Steven L. Taylor	01-01-09 to 12-31-10
Chief Financial Officer	Jeffrey L. Davis	01-01-09 to 12-31-10
Chairman of the Hospital Board	Paul Martin	01-01-09 to 12-31-10
President of the Board of County Commissioners	James Goldman	01-01-09 to 12-31-10



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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of the business-type activities, of the Harrison County Hospital (Hospital) as of and for the year ended December 31, 2009, as listed in the Table of Contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of the Harrison MOB, LLC, which represents 100% of the assets and revenues of the discretely presented component unit. Those financial statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Harrison MOB, LLC, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over reporting. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Hospital and its discretely presented component unit as of December 31, 2009, and the respective changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

STATE BOARD OF ACCOUNTS

October 14, 2010

HARRISON COUNTY HOSPITAL

Management Discussion and Analysis (MD&A)

This section of Harrison County Hospital's (HCH) annual financial statements presents background information and management discussion and analysis of the HCH financial performance for the year ended December 31, 2009. HCH reports results on a fiscal year of January 1 to December 31, and any reference to a year in this MD&A indicates the HCH fiscal years. This MD&A does not include a discussion and analysis of the activities and results of the Harrison County Hospital Foundation or the Harrison MOB LLC.

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

Financial Highlights

- HCH net assets decreased by \$1,363,705 in 2009, resulting from an operating loss of (\$1,479,218), net non-operating items of (\$473,770), a net loss from the investment in Harrison MOB, LLC (a discrete component unit) of (\$160,717), and contributed capital of \$750,000 from Harrison County.
- Total net patient revenue, net of provision for bad debt, decreased by 4.3%, while operating expenses increased by 2.1%. Net operating loss for the year was (\$1,479,218), a decrease of \$2,103,185 from 2008.
- Long term debt, including current maturities, is \$28,830,000. This amount represents revenue bonds payable for the new hospital construction. Payments related to the long term debt in 2009 consisted of principal of \$595,000 and interest of \$1,187,026.
- Effective December 15, 2005, HCH has operated as a Critical Access Hospital (CAH). The CAH program under Medicare was developed to assist smaller hospitals that service rural areas and areas of critical need, as it provides alternative reimbursement methods for patient services. Under the CAH program, Medicare will reimburse HCH at 101% of the allowable costs of providing services to Medicare patients.
- Construction was completed in February 2008 on the \$50 million replacement hospital facility. The funding was provided by: \$30 million in variable rate revenue bonds, backed by a five year renewable letter of credit commitment from J.P. Morgan Chase Bank, and issued through the Indiana Health and Educational Facility Finance Authority; a contribution from Harrison County of \$12 million, which was funded from the sharing of gaming tax revenue; a grant from the Harrison County Community Foundation of \$5 million; HCH cash reserves of \$3 million. The revenue bonds were sold in November of 2005. Following the sale of the revenue bonds, HCH entered into an interest rate SWAP covering \$25 million

of the \$30 million bond issue. The SWAP effectively fixes the interest rate at 3.81% for the life of those bonds.

The total cost of the facility and equipment was \$50,370,000. Investing in the new facility was an integral component of the HCH long-term plan to provide high quality health care to patients in the community.

- In July 2006 HCH entered into an agreement with several physicians and healthcare providers to establish Harrison MOB, LLC. This entity was formed to invest in and operate a new medical office building to be located on the campus of the new HCH facility. HCH has invested \$1,157,420 which includes ownership of approximately 58% of the shares of the LLC. Harrison MOB, LLC is a discrete component unit of HCH, and the financial statements are presented in a separate independent audit report.
- In April 2008 the Harrison County Commissioners and the Board of Trustees formed an agreement to construct an ambulance station on the hospital campus, which will replace the ambulance station on the vacated hospital campus. The building will be an asset of the hospital. The estimated total cost of the building is approximately \$1,000,000, with Harrison County contributing capital equaling 72% of the cost, up to a total of \$750,000, and HCH contributing the balance. Construction of the building was substantially completed in July 2010.
- In May 2008 the Harrison County Commissioners and the Board of Trustees approved the transfer of certain HCH land and buildings to Harrison County. The property to be transferred consists of the land and improvements, hospital buildings and medical office buildings that were taken out of service with the move to the new campus. The transfer took place on July 30, 2008. The properties carried an original cost of \$14,022,099, and had on July 30, 2008, total accumulated depreciation of \$10,367,222, leaving a book value of \$3,654,877. The resulting loss on disposal of the properties was treated as an extraordinary item in the 2008 financial statements.
- HCH continues to implement an upgraded and expanded hospital information system. Current projects in the planning stage include the implementation and extension of electronic health records systems, which are intended to improve the portability of health information. This is a significant investment in technology which improves quality of information for clinical and financial management, which in turn will facilitate improved quality of care. The enhanced information systems will also allow for operational efficiencies as patient volumes increase, and will be vital in conforming to regulatory requirements which continue to expand in number and complexity.
- Recruiting and retaining a core group of physicians has been part of the strategic plan of HCH for many years. In recent years HCH has entered into employment arrangements with a growing number of physicians, rather than the physicians maintaining independent practices. The strategy of hospitals employing physicians has become widespread due to changes in the industry which make the arrangement necessary and advantageous in many instances. The long term effect

of physician employment will be that an adequate number of primary care and specialty providers will be retained in the community, which in turn will generate patients and revenue streams for HCH. In the short term, salary and benefits costs will increase in total and in relation to net revenue, as it normally will take the physician practices three to five years to build and mature. More information on physician salaries and benefits is included in the Expenses section of this MD&A.

The Financial Statements

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

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

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

A summary of the HCH Net Assets as of December 31, 2009 and 2008 is presented below, in 000's:

	2009	2008	\$ Change	% Change
Assets:				
Cash and Investments	\$15,926	\$14,051	\$1,875	13.3%
Capital Assets	46,770	50,581	(3,811)	-7.5%
Other Assets	10,179	12,812	(2,633)	-20.6%
Restricted Assets - Cash	6,215	6,848	(633)	-9.2%
Restricted Assets - Receivable	<u>515</u>	<u>0</u>	<u>515</u>	N/A
Total Assets	<u><u>\$79,605</u></u>	<u><u>\$84,292</u></u>	<u><u>(\$4,687)</u></u>	-5.6%
Liabilities:				
Long Term Debt Outstanding	\$28,155	\$28,830	(\$675)	-2.3%
Current and Other Liabilities	<u>3,990</u>	<u>6,638</u>	<u>(2,648)</u>	-39.9%
Total Liabilities	<u><u>32,145</u></u>	<u><u>35,468</u></u>	<u><u>(3,323)</u></u>	-9.4%
Net Assets:				
Invested in Capital Assets - Net of Related Debt	17,939	21,156	(3,217)	-15.2%
Unrestricted	28,792	27,644	1,148	4.2%
Restricted	<u>729</u>	<u>24</u>	<u>705</u>	2937.5%
Total Net Assets	<u><u>47,460</u></u>	<u><u>48,824</u></u>	<u><u>(1,364)</u></u>	-2.8%
Total Liabilities and Net Assets	<u><u>\$79,605</u></u>	<u><u>\$84,292</u></u>	<u><u>(\$4,687)</u></u>	-5.6%

The decrease in total assets in 2009 was primarily due to depreciation recognized on capital assets, which consists of the new building and equipment acquired in 2008. In addition, other assets that were receivables from Medicare decreased as settlements were received for prior years, and this in turn contributed to the increase in cash.

Current and other liabilities decreased significantly at the end 2009 compared to 2008. There were several large accrued liability items in 2008, including the final invoice for the hospital construction of \$477,000, and accrued amounts for inter-company payables of \$1,582,600. There was a corresponding asset recognized in other assets for the inter-company amounts.

A summary of the HCH Statement of Operations and Changes in Net Assets as of December 31, 2009 and 2008 is presented below, in 000's:

	<u>2009</u>	<u>2008</u>	<u>\$ Change</u>	<u>% Change</u>
Revenue:				
Net Patient Service Revenue, net of provision for Bad Debt: 2009 (\$4,562); 2008(\$6,259)	\$38,461	\$40,186	(\$1,725)	-4.3%
Other	1,680	1,210	470	38.8%
Total Operating Revenue	<u>40,141</u>	<u>41,396</u>	<u>(1,255)</u>	<u>-3.0%</u>
Expenses:				
Salaries and Benefits	22,594	20,935	1,659	7.9%
Medical Supplies and Drugs	3,689	3,435	254	7.4%
Depreciation and Amortization	5,061	4,598	463	10.1%
Other	10,276	11,804	(1,528)	-12.9%
Total Operating Expenses	<u>41,620</u>	<u>40,772</u>	<u>848</u>	<u>2.1%</u>
Operating Income	(1,479)	624	(2,103)	-337.0%
Non-Operating Revenue	713	697	16	2.3%
Non-Operating Expense	(1,348)	(1,230)	(118)	-9.6%
Excess of Revenue over Expenses	(2,114)	91	(2,205)	-2423.1%
Capital Grants and Contributions	750	0	750	NA
Extraordinary Items	0	(4,120)	4,120	NA
Total Net Assets - Beginning of Year	<u>48,824</u>	<u>52,853</u>	<u>(4,029)</u>	<u>-7.6%</u>
Total Net Assets - End of Year	<u>\$47,460</u>	<u>\$48,824</u>	<u>(\$1,364)</u>	<u>-2.8%</u>

Sources of Revenue

During 2009 and 2008 HCH derived substantially all of its revenue from patient service and other related programs. Revenue is received from Medicare and Medicaid programs, self pay patients, insurance carriers, preferred provider organizations, and managed care companies. Other revenue includes subsidies from Harrison County for the operation of the county ambulance service, totaling \$1,266,729 in 2009 and \$724,472 in 2008.

The following table presents the percentages of gross revenue for patient services, by payor, for the years ended December 31, 2009 and 2008, respectively.

Payor	2009	2008
Medicare	43.8%	44.0%
Medicaid	14.0%	11.7%
Anthem	16.4%	18.0%
Commercial Insurance	3.4%	6.3%
Managed Care	12.0%	10.2%
Self Pay	7.2%	7.2%
Other	3.2%	2.6%
Total	100.0%	100.0%

Operating and Financial Performance

The financial operating performance of HCH receded slightly in 2009 compared to the prior year. This section will discuss the highlights of 2009 operations and changes in activity.

Revenue

Net patient revenue decreased 4.3% during 2009 primarily as a result of an unfavorable shift in third party payer mix. Medicaid utilization increased significantly, while utilization for managed care and commercial payers decreased. Medicaid reimbursements are generally much lower than those from other third party payers. Distributions from the Indiana Medicaid Municipal Disproportionate Share program decreased by \$2 million in 2009 compared to 2008. This was offset somewhat by a \$1.1 million decrease in write-offs for bad debt and charity care. Further discussion of revenue activity follows.

- Overall outpatient visits to HCH increased by 5% in 2009. This improvement is primarily the result of increases in emergency room visits and utilization of diagnostic testing services.
- Inpatient activity decreased in terms of patient days by 7%. This decrease reflects mild cold, flu and allergy seasons in 2009, which resulted in fewer elderly and chronically ill patients requiring acute care. Historical inpatient activity is in decline, which reflects the continued shift in the industry from inpatient services to outpatient services, as well as improvements in technology and case management which shorten the time of recovery and reduce hospital length of stay.
- The portion of deductions from gross revenue recognized by HCH for uninsured care and charity care in 2009 was \$7.2 million, or 8.0% of gross revenue, compared to \$8.2 million, or 9.8% of gross revenue in 2008. Uninsured care is included in provision for bad debt expense and represents uncollected charges for services not covered by insurance, and for patients that do not have health insurance. Charity care is recognized as a deduction from gross revenue, and represents charges written off that were incurred in providing care to uninsured and indigent patients. HCH has a policy and a commitment to provide emergency care to all patients without regard for their ability to pay for services. Over the past several years there has been a trend of increasing uninsured care, although the trend stabilized somewhat in 2009. The short term outlook for these revenue deductions remains unfavorable, considering the overall local economy and the health insurance industry climate.
- During 2009 net Medicare settlements of \$4,792,129 were received for the years 2007, 2008, and 2009, relating to the Medicare cost reports for those years. Under the Critical Access Hospital program, estimated interim payments are made by Medicare during the year, and then an initial settlement is made based on the cost report. The cost report determines the allowable cost of providing service to Medicare patients. The cost reports are then subject to subsequent reviews and audits, which may adjust the payment received or made on the initial settlement.
- Settlements totaling \$1,307,198 were received in 2009 under the Indiana Medicaid program, relating to the State of Indiana's fiscal year 2009. These payments were made as part of the Disproportionate Share Hospital program, and are recorded as offsets to revenue adjustments in the HCH accounting records. These payments were made from funds that are available to partially cover the hospital's cost of care to Medicaid and uninsured patients. These amounts are determined by the State through subsequent reviews and audits.

Expenses

Total operating expenses increased by 2.1% in 2009. Factors that had an impact on expenses are discussed below.

- Salaries and benefits costs for 2009 increased by \$1,659,000, an 8% increase from 2008. The increase is primarily due to the wage market adjustments and cost of living increases for employees, as well as the employment of several physicians and office staff for new practices. The number of full time equivalents (FTE's) increased slightly from an average of 375 in 2008 to 377 in 2009, as the increase of 7.5 FTE's in physician staff and physician office staff was offset somewhat by staff adjustments in several hospital departments. Wage and salary rate increases averaged 4.2% for 2009, a reflection of the current high inflation indexes associated with healthcare labor and benefit costs.
- All operating expenses other than salaries and benefits decreased by 4.1%, or \$810,000 from 2008. Expense for medical supplies and drugs increased by \$254,000 due to cost increases and higher outpatient visits. Expenses for depreciation and amortization increased by \$464,000 over 2008, as the first full year of depreciation was taken on the new building and equipment that was placed in service during 2008. Purchased services increased \$217,000, due to the addition in 2009 of maintenance contracts on new equipment after the expiration of a one year warranty period. Professional services expense decreased by \$693,000 with the conversion of the emergency room physician contract to a full outsourcing structure. Expense for non-depreciable minor equipment and supplies decreased by \$1,074,000 in 2009, as 2008 expense included the start-up costs for new furnishings, supplies, and minor equipment for the new facility.
- A capital contribution from Harrison County in the amount of \$750,000 was recognized in 2009. This contribution was designated to fund approximately 72% of a new EMS building. There were no extraordinary losses or gains in 2009, compared to an extraordinary loss of \$4,120,000 in 2008 that was recognized on the disposal of the old hospital facility and related equipment.

Long Term Debt

At fiscal year end 2009, HCH had total notes payable of \$28.2 million, which represents revenue bonds that HCH issued for the construction of the new hospital facility. Annual principal payments on these bonds began in October, 2008, with interest being paid monthly. More detailed information on HCH's long term debt is presented in the Notes to the Financial Statements.

Capital Assets

During 2009 HCH invested \$2 million in various capital assets. A summary of the capital assets is presented below, in 000's:

	<u>2009</u>	<u>2008</u>	<u>\$ Change</u>	<u>% Change</u>
Land and Land Improvements	\$6,737	\$6,636	\$101	1.5%
Buildings and Fixed Equipment	35,821	35,013	808	2.3%
Equipment	19,109	17,816	1,293	7.3%
Total Capital Assets	<u>61,667</u>	<u>59,465</u>	<u>2,202</u>	<u>3.7%</u>
Less Accumulated Depreciation	(15,392)	(10,374)	(5,018)	48.4%
Construction in Progress	494	1,490	(996)	-66.8%
Capital Assets - Net	<u>\$46,769</u>	<u>\$50,581</u>	<u>(\$3,812)</u>	<u>-7.5%</u>

HCH continues to invest in capital equipment in order to meet the needs of the service area population. These capital improvements result in increased service capacity, greater efficiencies, and upgraded technology. With the addition of substantially all new facilities and equipment in 2008, major asset purchases will be minimal for several years, with the probable exception of information systems. Federal and industry requirements to expand electronic health records systems will necessitate the upgrade of hospital and physician information systems.

The table below shows HCH's 2010 capital budget with projected spending of \$1.2 million for capital projects. Equipment to be placed in service in 2010 will be purchased from operating cash and cash reserves.

Capital Budget (in 000's)	2010
Equipment Replacement & Upgrades	\$450
Information Systems	<u>750</u>
Total Capital Budget	<u>\$1,200</u>

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

Economic and Industry Factors for 2010 Budget

The HCH Board of Trustees and management considered many factors when setting the 2010 budget. Of primary importance in setting the budget was the status of the economy and industry trends, which takes into account market forces and regulatory factors such as the following items:

- Population growth, demographic shifts, and the expanding need for services
- Continuously increasing expectations for quality improvement
- Advances in medical equipment technology and the need to replace obsolete equipment
- Privacy legislation – Health Insurance Portability and Accountability Act (HIPAA)
- Increasing emphasis on the integrity of public financial information
- Growing number of uninsured and underinsured patients
- Increasing costs of labor, medical supplies and drugs, and insurance
- Access to additional capital, and management of cash and debt levels
- Cash and resource requirements needed for the HCH strategic plan

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

Contacting HCH's Financial Manager

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

HARRISON COUNTY HOSPITAL
STATEMENT OF NET ASSETS
December 31, 2009

<u>Assets</u>	<u>Primary Government</u>
Current assets:	
Cash and cash equivalents	\$ 6,385,478
Short-term investments	9,540,781
Patient accounts receivable, net of estimated uncollectibles of \$6,903,366	4,974,329
Other receivables-restricted	514,749
Estimated third-party settlements	497,694
Supplies and other current assets	3,117,854
Noncurrent cash and investments:	
Internally designated	6,000,969
Held by trustee for debt service	162,863
Held by trustee for construction	51,503
Capital assets:	
Land and construction in progress	3,696,738
Depreciable capital assets, net of accumulated depreciation	43,072,562
Other assets:	
Investment in affiliated companies	1,164,145
Other	425,176
Total assets	<u>\$ 79,604,841</u>
 <u>Liabilities and Net Assets</u>	
Current liabilities:	
Current maturities of long-term debt	\$ 675,000
Accounts payable and accrued expenses	2,590,572
Other current liabilities	696,973
Long-term debt, net of current maturities	28,155,000
Other long-term liabilities	27,016
Total liabilities	<u>32,144,561</u>
Net assets:	
Invested in capital assets, net of related debt	17,939,300
Restricted:	
Expendable for debt service	162,863
Expendable for capital acquisitions	566,252
Unrestricted	<u>28,791,865</u>
Total net assets	<u>47,460,280</u>
Total liabilities and net assets	<u>\$ 79,604,841</u>

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

HARRISON COUNTY HOSPITAL
BALANCE SHEET - DISCRETE COMPONENT UNIT
December 31, 2009

<u>Assets</u>	<u>Discrete Component Unit</u>
Current assets:	
Cash	\$ 16,803
Receivables:	
Tenants - rent	2,771
Tenants - suite improvements	<u>22,634</u>
Net receivables	<u>25,405</u>
Prepaid expenses	<u>42,238</u>
Total current assets	<u>84,446</u>
Other asset:	
Unamortized loan costs (net of amortization of \$37,334)	124,314
Property:	
Tenant improvements	2,474,919
Buildings	<u>4,712,880</u>
Total property	7,187,799
Less accumulated depreciation	<u>252,221</u>
Net property	<u>6,935,578</u>
Total assets	<u>\$ 7,144,338</u>
 <u>Liabilities and Members' Equity</u>	
Current liabilities:	
Current installments of long-term debt	\$ 85,561
Accounts payable	19,391
Accounts payable - related party	18,979
Deferred revenue	<u>5,492</u>
Total current liabilities	<u>129,423</u>
Long-term liabilities:	
Long-term debt, less current installments	5,535,837
Interest rate swap	<u>921,220</u>
Total long-term liabilities	<u>6,457,057</u>
Members' equity:	
Contributed capital	1,577,515
Deficit	(125,084)
Accumulated other comprehensive loss	<u>(894,573)</u>
Total members' equity	<u>557,858</u>
Total liabilities and members' equity	<u>\$ 7,144,338</u>

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

HARRISON COUNTY HOSPITAL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year Ended December 31, 2009

	<u>Primary Government</u>
Operating revenues:	
Net patient service revenue (net of provision for bad debt)	\$ 38,461,199
Other	<u>1,680,262</u>
Total operating revenues	<u>40,141,461</u>
Operating expenses:	
Salaries and benefits	22,594,242
Professional fees and purchased services	6,208,045
Medical supplies and drugs	3,688,670
Insurance	573,862
Other supplies	2,179,180
Depreciation and amortization	5,061,488
Other	<u>1,315,192</u>
Total operating expenses	<u>41,620,679</u>
Operating loss	<u>(1,479,218)</u>
Nonoperating revenues (expenses):	
Investment income	616,562
Interest expense	(1,187,026)
Noncapital grants and contributions	83,913
Gain on sale of equipment	12,781
Loss on investment in affiliated companies	<u>(160,717)</u>
Total nonoperating expenses	<u>(634,487)</u>
Deficiency of revenues under expenses before capital grants and contributions	(2,113,705)
Capital grants and contributions	<u>750,000</u>
Decrease in net assets	(1,363,705)
Net assets beginning of the year	<u>48,823,985</u>
Net assets end of the year	<u>\$ 47,460,280</u>

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

HARRISON COUNTY HOSPITAL
STATEMENT OF INCOME, EXPENSES, AND CHANGES IN MEMBERS' EQUITY -
DISCRETE COMPONENT UNIT
Year Ended December 31, 2009

	<u>Discrete Component Unit</u>
Rental income	\$ <u>752,577</u>
Operating expenses:	
Utilities	90,773
Rent	59,361
Repairs and maintenance	13,483
Insurance	6,822
Depreciation	227,656
Amortization	16,165
Professional fees	8,000
Cleaning	14,099
Security	9,827
Miscellaneous	<u>653</u>
Total operating expenses	<u>446,839</u>
Operating income	<u>305,738</u>
Other income (expenses):	
Interest income	827
Interest expense	(379,483)
Loss on interest rate swap	<u>(26,647)</u>
Total other expenses	<u>(405,303)</u>
Deficiency of income under expenses before other comprehensive loss, capital contributions, and return of capital distributions	(99,565)
Other comprehensive loss	(894,573)
Capital contributions	30,000
Return of capital distributions	<u>(47,250)</u>
Members' equity beginning of the year	<u>1,569,246</u>
Members' equity end of the year	<u>\$ 557,858</u>

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

HARRISON COUNTY HOSPITAL
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS
Year Ended December 31, 2009

	<u>Primary Government</u>
Cash flows from operating activities:	
Receipts from and on behalf of patients	\$ 38,142,794
Payments to suppliers and contractors	(14,031,319)
Payments to employees	(22,474,895)
Other receipts and payments, net	<u>2,967,385</u>
Net cash provided by operating activities	<u>4,603,965</u>
Cash flows from noncapital financing activities:	
Noncapital grants and contributions	<u>83,913</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(799,766)
Principal paid on long-term debt	(595,000)
Interest paid on long-term debt	(1,187,026)
Proceeds from sale of assets	<u>31,663</u>
Net cash used by capital and related financing activities	<u>(2,550,129)</u>
Cash flows from investing activities:	
Interest and dividends on investments	90,150
Loan to affiliated company	(250,000)
Investment in affiliated company	(30,000)
Proceeds from sale of investments	<u>7,542,367</u>
Net cash provided by investing activities	<u>7,352,517</u>
Net increase in cash and cash equivalents	9,490,266
Cash and cash equivalents at beginning of year	<u>1,840,467</u>
Cash and cash equivalents at end of year	<u>\$ 11,330,733</u>
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents in current assets	\$ 6,385,478
Internally designated cash and cash equivalents	<u>4,945,255</u>
Total cash and cash equivalents	<u>\$ 11,330,733</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (1,479,218)
Adjustments to reconcile operating loss to net cash flows provided in operating activities:	
Depreciation and amortization	5,061,488
Provision for bad debts	4,561,752
(Increase) decrease in current assets:	
Patient accounts receivable	(4,880,157)
Estimated third-party payor settlements	2,199,197
Supplies and other current assets	729,068
Increase (decrease) in current liabilities:	
Accounts payable and accrued expenses	(1,518,969)
Other current liabilities	129,844
Estimated third-party payor settlements	95,774
Other liabilities related to operating activities	<u>(294,814)</u>
Net cash provided in operating activities	<u>\$ 4,603,965</u>

Noncash investing, capital, and financing activities:

The Hospital received a contribution of capital assets from Harrison County of \$235,251 for the EMS building project.

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

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

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

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

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

Discretely Presented Component Unit

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

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

Harrison County Hospital
1141 Hospital Drive NW
Corydon, IN 47112

A separate audit report is prepared for the individual component unit.

B. Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the enterprise fund statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their enterprise funds, subject to this same limitation. The Hospital has elected not to follow subsequent private-sector guidance.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

C. Assets, Liabilities and Net Assets or Equity

1. Deposits and Investments

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

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

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

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

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

Open-end mutual funds are reported at fair value.

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

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

Other investments are generally reported at fair value.

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

2. Use of Estimates

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

3. Capital Assets

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

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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:

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

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

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. The total interest expense incurred by the Hospital during the current year was \$1,187,026. Of the amount, \$0 was included as part of the cost of capital assets under construction in connection with new medical facilities and various other renovation projects. The total interest expense incurred by the discrete component unit during the current year was \$382,798. Of the amount, \$3,315 was included as part of the cost of the cost of building and improvements.

4. Net Assets and Members' Equity

Net assets of the Hospital are classified in three components.

Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, contributors, or enabling legislation external to the hospital, including amounts deposited with trustees as required by revenue bond indentures, discussed in Note II G.

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

Members' equity of the discrete component unit is classified in three components.

Contributed capital consists of purchases of shares of units net of any return of capital distributions.

Deficit is the accumulated net income (loss).

Accumulated other comprehensive loss consists of the gain or loss on the effective portion of the change in the fair value of the derivative financial instrument.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

D. Grants and Contributions

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

From time to time, the Harrison MOB, LLC, receives contributions from Harrison County Hospital, individuals and private organizations. Revenues from contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as other income. Amounts restricted to capital acquisitions are reported after other income and expenses.

E. Restricted Resources

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

F. Operating Revenues and Expenses

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

G. Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue represents the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. 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.

H. Charity Care

The Hospital has a policy of providing charity care to patients who are unable to pay. Such patients are identified based on financial information obtained from the patient and subsequent analysis. Because the agency does not expect payment, estimated charges for charity are not included in revenue.

I. Supplies

Inventories of drugs and other supplies are stated at the lower of cost (first-in, first-out) or market.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

J. Compensated Absences

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

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

K. Fair Value of Financial Instruments

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

Cash and Cash Equivalents

The carrying amount reported in the Statement of Net Assets for cash and cash equivalents approximates its fair value.

Short-Term Investments

The carrying amount reported in the Statement of Net Assets is the investment's fair value on the day it becomes a short-term investment.

Investments

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

Accounts Payable and Accrued Expenses

The carrying amount reported in the Statement of Net Assets for accounts payable and accrued expenses approximates its fair value.

Estimated Third-Party Payor Settlements

The carrying amount reported in the Statement of Net Assets for estimated third-party payor settlements approximates its fair value.

Long-Term Debt

Effective January 1, 2009, the discrete component unit adopted the provisions of ASC 820 (formerly Statement of Financial Accounting Standards No. 157), Fair Value Measurements, for financial assets and financial liabilities. The discrete component unit has no nonfinancial assets and nonfinancial liabilities determined at fair value.

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Inputs to the valuation methodology are quoted prices, unadjusted for identical assets or liabilities in active markets. A quoted market price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.
2. Inputs to the valuation methodology include quoted market prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted market prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that are derived principally from or can be corroborated by observable market data by correlation or other means.
3. Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The discrete component unit's interest rate swap liability is measured on a recurring basis. As of December 31, 2009, the balance of the interest rate swap is \$921,220, using level 2 above.

The interest rate swap is reported at fair value on a recurring basis using Level 2 inputs. The fair value is based on expected cash flows over the life of the contract. The expected cash flows are determined by evaluating transactions with a pricing model using a specific market environment. The value of the interest rate swap was estimated using the closing mid-market rate/price environment of December 31, 2009. While management believes the discrete component unit's valuation methodologies are appropriate and consistent, the use of different methodologies or assumptions to determine fair value could result in a different estimate of fair value at the reporting date.

Derivative Financial Instrument

The discrete component unit has designated a fixed rate interest rate swap as a cash flow hedge of the variability of cash flows to be paid on long-term debt. The gain or loss on the effective portion of the hedge (i.e., change in the fair value) is initially recorded as a component of other comprehensive income. The remaining gain or loss, if any, representing the ineffective portion is recognized currently in earnings. Amounts in accumulated other comprehensive income are reclassified into earnings in the same period in which the hedged forecasted transaction affects earnings (when interest expense is recognized in earnings).

The discrete component unit documents the relationship between its hedging instruments and hedged liabilities. This process includes linking all derivatives that are designated as cash flow hedges to specific forecasted interest payments for long-term debt.

The discrete component unit assesses both at the cash flow hedge's inception and on an ongoing basis, whether the derivative instruments that are used in hedging transactions have been highly effective in offsetting changes in cash flows and whether they are expected to continue to be highly effective in future periods. When it is determined that a derivative has ceased to be highly effective as a cash flow hedge, the discrete component unit discontinues hedge accounting prospectively.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

The discrete component unit discontinues cash flow hedge accounting prospectively when (1) it is determined that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item; (2) the derivative expires or is sold, terminated, or exercised; (3) the derivative is de-designated as a hedge instrument, because it is unlikely that the forecasted transaction (cash flows) will occur; or (4) management determines that designation of the derivative as a hedge instrument is no longer appropriate. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the net derivative gain or loss that was accumulated in other comprehensive income will be recognized immediately in earnings. In all other situations in which cash flow hedge accounting is discontinued, the net derivative gain or loss related to the discontinued cash flow hedge remains in accumulated other comprehensive income and is reclassified into earnings in the same period or periods during which the hedged forecasted transaction offsets earnings.

II. Detailed Notes

A. Deposits and Investments

1. Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 16-22-3-16 allows a Hospital Governing Board to deposit public funds in a financial institution. The Hospital does not have a formal policy regarding custodial credit risk for deposits. At December 31, 2009, the Hospital had deposit balances in the amount of \$23,122,708.

The bank balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

Harrison MOB, LLC, maintains its cash at financial institutions. At times, the balances may be in excess of federally insured limits.

2. Investments

Authorization for investment activity is stated in Indiana Code 16-22-3-20. As of December 31, 2009, the Hospital had the following investments:

Investment Type	Primary Government Market Value
U.S. treasuries and securities	\$ 214,366

Statutory Authorization for Investments

Indiana Code 16-22-3-20 authorizes the Hospital to invest in:

Any interest-bearing account that is authorized to be set up and offered by a financial institution or brokerage firm registered and authorized to do business in Indiana.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Repurchase or resale agreements involving the purchase and guaranteed resale of any interest-bearing obligations issued or fully insured or guaranteed by the United States or any United States government agency in which type of agreement the amount of money must be fully collateralized by interest-bearing obligations as determined by the current market value computed on the day the agreement is effective.

Mutual funds offered by a financial institution or brokerage firm registered and authorized to do business in Indiana.

Securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

Pooled fund investments for participating hospitals offered, managed, and administered by a financial institution or brokerage firm registered or authorized to do business in Indiana.

Investment Custodial Credit Risk

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

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Hospital does not have a formal investment policy for interest rate risk for investments. The Hospital's investments did not have interest rate risk.

Credit Risk

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

Concentration of Credit Risk

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

Foreign Currency Risk

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

B. Accounts Receivable and Payable

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

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Patient Accounts Receivable

Receivable from patients and their insurance carriers	\$ 6,993,712
Receivable from Medicare	3,366,376
Receivable from Medicaid	<u>1,517,607</u>
 Total patient accounts receivable	 11,877,695
 Less allowance for uncollectible amounts	 <u>6,903,366</u>
 Patient accounts receivable, net	 <u><u>\$ 4,974,329</u></u>

Accounts Payable and Accrued Expenses

Payable to employees (including payroll taxes)	\$ 734,569
Payable to suppliers	1,798,998
Other	<u>57,005</u>
 Total accounts payable and accrued expenses	 <u><u>\$ 2,590,572</u></u>

C. Capital Assets

Capital asset activity for the year ended December 31, 2009, was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 3,195,260	\$ 7,161	\$ -	\$ 3,202,421
Construction in progress	<u>1,490,041</u>	<u>983,751</u>	<u>1,979,475</u>	<u>494,317</u>
 Total capital assets, not being depreciated	 <u>4,685,301</u>	 <u>990,912</u>	 <u>1,979,475</u>	 <u>3,696,738</u>
Capital assets, being depreciated:				
Land improvements	3,441,104	93,741	500	3,534,345
Buildings and fixed equipment	35,012,383	911,862	103,060	35,821,185
Equipment	<u>17,816,243</u>	<u>1,411,961</u>	<u>118,719</u>	<u>19,109,485</u>
 Totals	 <u>56,269,730</u>	 <u>2,417,564</u>	 <u>222,279</u>	 <u>58,465,015</u>
Less accumulated depreciation for:				
Land improvements	464,246	253,357	500	717,103
Buildings and fixed equipment	2,300,232	2,017,676	-	4,317,908
Equipment	<u>7,609,622</u>	<u>2,772,999</u>	<u>25,179</u>	<u>10,357,442</u>
 Totals	 <u>10,374,100</u>	 <u>5,044,032</u>	 <u>25,679</u>	 <u>15,392,453</u>
 Total capital assets, being depreciated, net	 <u>45,895,630</u>	 <u>(2,626,468)</u>	 <u>196,600</u>	 <u>43,072,562</u>
 Total primary government capital assets, net	 <u><u>\$ 50,580,931</u></u>	 <u><u>\$ (1,635,556)</u></u>	 <u><u>\$ 2,176,075</u></u>	 <u><u>\$ 46,769,300</u></u>

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

<u>Discretely Presented Component Unit</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets, being depreciated:				
Tenant Improvements	\$ 2,442,793	\$ 32,126	\$ -	\$ 2,474,919
Buildings	<u>4,679,824</u>	<u>33,056</u>	<u>-</u>	<u>4,712,880</u>
Totals	<u>7,122,617</u>	<u>65,182</u>	<u>-</u>	<u>7,187,799</u>
Less accumulated depreciation	<u>24,565</u>	<u>227,656</u>	<u>-</u>	<u>252,221</u>
Total discretely presented component unit capital assets, net	<u>\$ 7,098,052</u>	<u>\$ (162,474)</u>	<u>\$ -</u>	<u>\$ 6,935,578</u>

D. Construction Commitments

Construction work in progress is composed of the following:

<u>Project</u>	<u>Total Project Authorized</u>	<u>Expended to December 31, 2009</u>	<u>Committed</u>
Information Systems	\$ 35,000	\$ 8,030	\$ 26,970
EMS Building	<u>1,000,000</u>	<u>486,287</u>	<u>513,713</u>
Totals	<u>\$ 1,035,000</u>	<u>\$ 494,317</u>	<u>\$ 540,683</u>

E. Operating Leases

The Hospital has entered into various operating leases having initial or remaining noncancelable terms exceeding one year for office space. Rental expenditures for these leases were \$534,259. The following is a schedule by years of future minimum rental payments as of year end:

2010	\$ 537,444
2011	521,927
2012	475,375
2013	475,375
2014	475,375
Thereafter	<u>1,901,500</u>
Total	<u>\$ 4,386,996</u>

F. Long-Term Liabilities

1. Revenue Bonds

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

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Purpose	Interest Rates	Amount
2005 Hospital construction revenue bonds	Variable	<u>\$ 28,830,000</u>

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

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

Under the swap agreement, the Hospital pays the counterparty, U.S. Bancorp Piper Jaffray Financial Products Inc., a fixed payment of 3.81% and receives a variable payment computed as 70% of the London Interbank Offered Rate (LIBOR). The swap has equal notional amount totaling \$25,000,000 and the associated auction rate bonds have a \$25,000,000 principal amount. The swap was entered into at the same time the bonds were issued in November 2005. The notional value of the swap declined by \$595,000 in 2009 and in increasing amounts in future years as the principal amount of the associated debt declines. The auction rate on the bonds closely approximates the Bond Market Association Municipal Swap Index (BMA). The bonds and related swap agreement matures on October 1, 2032. As of December 31, 2009, rates were as follows:

	Terms	Rates (%)
Interest rate swap:		
Fixed payment to counterparty	Fixed	3.81%
Variable payment from counterparty	70% of LIBOR	<u>0.24%</u>
Net interest rate swap payments		3.57%
Variable auction-rate bond payments		<u>0.28%</u>
Synthetic interest rate of bonds		<u>3.85%</u>

As of December 31, 2009, the swap had a negative fair value of \$2,250,002. The negative fair value of the swap may be countered by reductions in total interest payments required by the auction rate bond, creating lower synthetic rates. Because the auction rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase.

As of December 31, 2009, the Hospital was not exposed to credit risk in the amount of the derivative's fair value, because the swap had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the Hospital would be exposed to credit risk. The swap counterparty is currently rated A by Standard & Poor's, A2 by Moody's Investors Service and A by Fitch Ratings. The swap agreement does not contain collateral provisions for either party.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

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

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

As of December 31, 2009, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their terms were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Year Ending December 31	Variable-Rate Bonds		Interest Rate	Total
	Principal	Interest	Swap, Net	Debt Service
2010	\$ 675,000	\$ 78,834	\$ 1,005,134	\$ 1,758,968
2011	865,000	76,412	974,253	1,915,665
2012	895,000	73,906	942,302	1,911,208
2013	930,000	71,302	909,101	1,910,403
2014	960,000	68,614	874,829	1,903,443
2015-2019	5,345,000	299,222	3,815,081	9,459,303
2020-2024	6,365,000	216,020	2,754,255	9,335,275
2025-2029	7,575,000	116,998	1,491,725	9,183,723
2030-2032	5,220,000	14,952	190,638	5,425,590
Totals	<u>\$ 28,830,000</u>	<u>\$ 1,016,260</u>	<u>\$ 12,957,318</u>	<u>\$ 42,803,578</u>

2. Harrison MOB, LLC, Note Payable

Long-term debt at December 31, 2009, was as follows:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Purpose	Interest Rates	Amount
Note payable to Harrison County Hospital in monthly installments of interest only, principal due April 2012	7.50%	\$ 250,000
Note payable in monthly installments of principal and interest at one month LIBOR plus 1.25% maturing July 2017	Variable	<u>5,371,398</u>
Total		<u>\$ 5,621,398</u>

Harrison MOB, LLC (LLC) entered into a credit agreement in July 2007 to finance the construction of a medical office building. During construction, the agreement required payments of interest only on the outstanding balance. Upon substantial completion of the building, the agreement requires the commencement of principal payments to repay the obligation over 25 years. At December 31, 2008, the building was still under construction and no principal was currently due. In February 2009, the building was deemed substantially complete and the LLC started making principal payments to amortize the balance of the loan of \$5,440,000 over 25 years. Upon the commencement of principal payments, the interest rate on the loan decreased from LIBOR plus 1.35% to LIBOR plus 1.25%.

Following is a schedule by years of maturity requirements on long-term debt as of December 31, 2009:

Year Ending December 31	
2010	\$ 85,561
2011	91,948
2012	348,810
2013	106,185
2014	114,111
Later years	<u>4,874,783</u>
Total	<u>\$ 5,621,398</u>

The note payable is secured by all the LLC's assets and assignments of rents. The note payable was guaranteed by the Harrison County Hospital until the commencement of the payment of principal in February 2009.

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, the LLC entered into an interest rate swap agreement to hedge the variability in the forecasted interest payments for the variable rate term note described above. The agreement provides for the LLC to receive interest from the counterparty at one month LIBOR and to pay interest to the counterparty at a fixed rate of 5.97% on

HARRISON COUNTY HOSPITAL
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the outstanding notional amount which amortizes based on the expected amortization of the variable rate term note. At December 31, 2009, the fair value of the interest rate swap agreement was a liability in the amount of \$921,220. This agreement was effective February 15, 2009, with the commencement of principal payments on the variable rate term note.

Summary information with respect to the interest rate swap agreement at December 31, 2009, was as follows:

	Fair Value	Notional Amount
Portion designated as a hedge	\$ 894,573	5,371,398
Portion not designated as a hedge	26,647	160,008
 Total interest rate swap	 \$ 921,220	 \$ 5,531,406

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2009, was as follows:

Primary Government	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable:					
Revenue:					
Indiana Health and Educational Facility Financing Authority	\$ 29,425,000	\$ -	\$ 595,000	\$ 28,830,000	\$ 675,000
 Discretely Presented Component Unit					
General long-term debt	\$ 4,759,136	\$ 930,787	\$ 68,525	\$ 5,621,398	\$ 85,561

4. Net Revenue Available for Debt Service

The following disclosures concerning net revenue available for debt service applicable to the years ended December 31, 2009, are required by terms of the financing agreement between the Hospital and IHFFA:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
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Revenue from operations	\$ 40,141,461
Investment income	616,562
Add/(Less):	
Net gain on disposal of assets	12,781
Expenses (excluding depreciation, amortization and interest on funded debt)	<u>(36,559,191)</u>
 Total net revenue available for debt service	 <u><u>\$ 4,211,613</u></u>
 Funded debt service for year	 <u><u>\$ 1,782,157</u></u>
 Historical debt service coverage ratio	 <u><u>2:36</u></u>

G. Restricted Net Assets

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

	<u>2009</u>
Expendable for Debt Service:	
General	162,863
Expendable for capital acquisitions:	
Building and equipment	<u>566,252</u>
 Total expendable, restricted net assets	 <u><u>\$ 729,115</u></u>

H. Net Patient Service Revenue

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

1. Medicare

Inpatient acute care services and most outpatient services rendered to Medicare program beneficiaries are paid at 101% of allowable costs as reported on an annual Medicare Cost Report. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

2. Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under bundled payments and fee for service payments, at amounts determined by the state. The Hospital is reimbursed at these rates on an interim basis, with subsequent lump sum payments made that are based on formulas which factor in the amount and types of services to uninsured and Medicaid patients.

HARRISON COUNTY HOSPITAL
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Revenue from the Medicare and Medicaid programs accounted for approximately 40.13% and 6.51%, respectively, of the Hospital's net patient service revenue, net of bad debt expense, for the year ended 2009. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The 2009 net patient service revenue decreased approximately \$1,667,497 due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations.

The Hospital also has entered into payment agreements with certain commercial insurance carriers, HMO's, 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.

I. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were \$2,588,368 (6.73%) for 2009.

J. Internally Designated Assets

Noncurrent cash and investments internally designated include the following:

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

Internally designated:	
Funded depreciation:	
Cash and cash equivalents	\$ 4,945,255
Investments	<u>1,055,714</u>
Total internally designated	<u><u>\$ 6,000,969</u></u>

III. Other Information

A. Risk Management

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

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

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NOTES TO FINANCIAL STATEMENTS
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Medical Benefits to Employees and Dependents

The Hospital has chosen to establish a risk financing fund for risks associated with medical benefits to employees and dependents. The risk financing fund is accounted for in the Operating Fund where assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of \$45,000 per year. Settled claims resulting from this risk did not exceed commercial insurance coverage in the past three years. Amounts are paid into the fund by all departments and are available to pay claims, claim reserves, and administrative costs of the program. Provisions are also made for unexpected and unusual claims.

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 (IBNRs). Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of payouts and other economic and social factors.

However, claim liabilities cannot be reasonably estimated.

B. Subsequent Events

The Hospital constructed a new Emergency Medical Services (EMS) facility on the campus at 1141 Hospital Drive, NW, Corydon, Indiana, with an estimated cost of \$1,043,000. The EMS facility was occupied on July 1, 2010. The Hospital approved up to \$293,000 toward funding of the facility, with the remainder to be funded with contributions.

The Hospital entered into a new Line of Credit Agreement with JP Morgan Chase Bank, N.A., on their 2005 revenue bonds. The Hospital estimates that the increase in fees will be approximately \$450,000 each year.

The Hospital approved an Information Technology upgrade to their Meditech program with an estimated cost of \$1.4 million.

C. Contingent Liabilities

Litigation

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

D. Fair Value Measurements

The Hospital has characterized its investments in securities, based on the priority of the inputs used to value the investments, into a three level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1), and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the investments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the investment.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
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Investments recorded in the statement of net assets are categorized based on the inputs to valuation techniques as follows:

Level 1 – These are investments where values are based on unadjusted quoted prices for identical assets in an active market the Hospital has the ability to access.

Level 2 – These are investments where values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the investments. These investments are comprised of corporate and municipal bonds that trade infrequently and privately held securities and certificates of deposit.

Level 3 – These are investments where values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect assumptions of management about assumptions market participants would use in pricing the investments. These investments could be certain private equity investments.

Based upon the levels as defined the investments as of December 31, 2009, are classified as follows:

Hospital Investment Type	December 31, 2009	Fair Value Measurements at Reporting Date Using:		
		Quoted Prices in Active Markets For Identical (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government securities	\$ 214,366	\$ -	\$ 214,366	\$ -
Cetificates of deposit	10,596,495	-	10,596,495	-
Totals	<u>\$ 10,810,861</u>	<u>\$ -</u>	<u>\$ 10,810,861</u>	<u>\$ -</u>

E. Investment in Affiliated Companies

Harrison-Floyd Health Services, LLC

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

Summarized financial information as of December 31, 2009, and for the year then ended from the unaudited financial statements of the affiliated company follows:

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NOTES TO FINANCIAL STATEMENTS
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Current assets	\$ 43,016
Noncurrent assets	79,054
Current liabilities	14,583
Net assets	107,487
Revenues	88,156
Expenses	120,956
Net loss	(32,800)

Harrison MOB, LLC

On July 26, 2006, the Hospital entered into an agreement with several physicians and physician groups to establish and operate a medical office building to be located on the Hospital's campus in Corydon, Indiana, known as Harrison MOB, LLC (LLC). In accordance with this agreement, 68 Class A units and 37 Class B units were sold for \$10,000 each, for an aggregate proceeds of \$1,050,000. Each unit represents an equity interest of approximately .952% in the company. The Hospital purchased 61 units for an investment of \$610,000 representing approximately 58.10% equity interest in the company. The medical office building was operational as of February 2009. The Hospital committed to lease available finished square footage in the building up to a 90% occupancy level for the first five years and up to 85% occupancy level for the next five years. The investment is recorded on the equity method. The Hospital's investment in affiliated company is included in the Other assets category of the Statement of Net Assets.

In July 2007, the LLC entered into a credit agreement in the principal amount of \$5,440,000 to finance the construction of a medical office building on the campus of Harrison County Hospital. In February 2009, the building was deemed substantially complete and the LLC began making principal payments to amortize the balance of the loan of \$5,440,000 over 25 years. The note payable is secured by all the LLC's assets, assignments of rents and a guarantee by Harrison County Hospital.

Summarized financial information as of December 31, 2009, and for the year then ended from the audited financial statements of the affiliated company follows:

Current assets	\$ 84,446
Other assets	124,314
Capital assets, net	6,935,578
Current liabilities	129,423
Noncurrent liabilities	6,457,057
Members' equity	557,858
Revenues	753,404
Expenses	852,969
Net loss	(99,565)

F. Revenues Pledged

Revenues Pledged in Connection with Component Unit Debt

The Hospital has entered into a 10 year master lease agreement with Harrison MOB, LLC, which requires the Hospital to rent enough space to maintain a 90% occupancy level during the first five years starting February 2009. During the remaining five years of the agreement the requirement drops to 85%. For the year ended December 31, 2009, the Hospital's leases totaled \$473,546.

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NOTES TO FINANCIAL STATEMENTS
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G. Pension Plan

Hospital Pension Plan

Plan Description

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

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

Funding Policy and Annual Pension Cost

The contribution requirements of plan members are established by the written agreement between the Hospital Board of Trustees and the Plan Administrator. Plan members are voluntary and are established by written authorization for payroll deduction into an annuity savings account. The Hospital is required to contribute at an actuarially determined rate. The current rate is 5% of annual covered payroll. Employer and employee contributions to the plan were \$609,554 and \$710,009, respectively.

HARRISON COUNTY HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on October 14, 2010, with Steven L. Taylor, Chief Executive Officer; Jeffrey L. Davis, Chief Financial Officer; Paul Martin, Chairman of the Hospital Board; Donn Blank, Hospital Board member; and Keith Lieber, Controller. Our audit disclosed no material items that warrant comment at this time.