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December 28, 2010

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

We have reviewed the audit report prepared by Blue & Company, 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 Dunn Memorial Hospital, 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

DUNN MEMORIAL HOSPITAL

COMBINED FINANCIAL STATEMENTS

AND

REQUIRED SUPPLEMENTARY INFORMATION

DECEMBER 31, 2009 AND 2008

CPAs / ADVISORS



DUNN MEMORIAL HOSPITAL

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Dunn Memorial Hospital
Bedford, Indiana

We have audited the accompanying combined balance sheets of Dunn Memorial Hospital (Hospital) and its discretely presented component unit, collectively a component unit of Lawrence County, as of December 31, 2009 and 2008 and the related combined statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

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

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

Board of Trustees
Dunn Memorial Hospital
Bedford, Indiana

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

Blue & Co., LLC

May 28, 2010, except for Note 17, as to which the date is June 21, 2010.

REQUIRED SUPPLEMENTARY INFORMATION

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2009 AND 2008

This section of Dunn Memorial Hospital's (Hospital) annual combined financial statements presents background information and management's discussion and analysis (MD&A) of the Hospital's financial performance during the year ended December 31, 2009. This MD&A includes a discussion and analysis of the activities and results of the Hospital only and does not include the Hospital's discrete component unit. Please read this MD&A in conjunction with the Hospital's combined financial statements that follow.

FINANCIAL HIGHLIGHTS

- The Hospital reported a decrease in net assets of approximately \$1,269,000 and \$1,503,000 for the years ended 2009 and 2008 respectively.

USING THIS ANNUAL REPORT

The Hospital's combined financial statements consist of three statements – a Balance Sheet; a Statement of Revenues and Expenses and Changes in Net Assets; and a Statement of Cash Flows. These combined financial statements and related notes provide information about the activities and the financial position of the Hospital.

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

All of the current year's revenue earned and expenses incurred and the changes in net assets for the year are accounted for in the Combined Statement of Revenues and Expenses and Changes in Net Assets.

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

THE COMBINED BALANCE SHEET AND COMBINED STATEMENT OF REVENUES AND EXPENSES AND CHANGES IN NET ASSETS

One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues and expenses and changes in net assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2009 AND 2008

These two statements report the Hospital's net assets and changes in them. Think of the Hospital's net assets—the difference between assets and liabilities—as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. Consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Hospital.

THE HOSPITAL'S NET ASSETS

Assets, Liabilities, and Net Assets

| | <u>2009</u> | <u>2008</u> | <u>Change</u> |
|--|----------------------|----------------------|-----------------------|
| Assets | | | |
| Current assets | \$ 11,429,211 | \$ 12,136,175 | \$ (706,964) |
| Capital assets, net | 17,696,633 | 18,589,762 | (893,129) |
| Assets whose use is limited | 659,406 | 112,215 | 547,191 |
| Other assets | 1,190,995 | 1,243,082 | (52,087) |
| Total assets | <u>\$ 30,976,245</u> | <u>\$ 32,081,234</u> | <u>\$ (1,104,989)</u> |
| Liabilities | | | |
| Current liabilities | \$ 7,029,327 | \$ 6,630,428 | \$ 398,899 |
| Long-term debt | 7,211,672 | 7,446,381 | (234,709) |
| Total liabilities | 14,240,999 | 14,076,809 | 164,190 |
| Net assets | | | |
| Invested in capital assets, net of related debt | 9,920,112 | 10,869,897 | (949,785) |
| Restricted debt service reserve funds | 1,088,431 | 3,700,000 | (2,611,569) |
| Unrestricted | 5,726,703 | 3,434,528 | 2,292,175 |
| Total net assets | <u>16,735,246</u> | <u>18,004,425</u> | <u>(1,269,179)</u> |
| Total liabilities and net assets | <u>\$ 30,976,245</u> | <u>\$ 32,081,234</u> | <u>\$ (1,104,989)</u> |

Current assets decreased primarily related to a decrease in patient accounts receivable and a movement of the combined cash and assets whose use is limited amount from current to long-term. Capital assets, net decreased primarily due to depreciation expense exceeding capital asset additions. Assets whose use is limited increased primarily as a result of income on investments and additional funds added to investments. Current liabilities increased by \$399,000 mostly due to an increase in third-party liabilities.

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2009 AND 2008

OPERATING RESULTS AND CHANGES IN THE HOSPITAL'S NET ASSETS

| | <u>2009</u> | <u>2008</u> | <u>Change</u> |
|---|----------------------|----------------------|-----------------------|
| Operating revenue | | | |
| Net patient service revenue | \$ 34,803,037 | \$ 36,411,946 | \$ (1,608,909) |
| Other operating revenue | 1,226,198 | 1,451,838 | (225,640) |
| Total operating revenue | <u>36,029,235</u> | <u>37,863,784</u> | <u>(1,834,549)</u> |
| Operating expenses | | | |
| Salaries and benefits | 22,244,228 | 23,024,579 | (780,351) |
| Purchased services and professional fees | 4,910,697 | 4,638,494 | 272,203 |
| Depreciation and amortization | 1,871,003 | 2,242,471 | (371,468) |
| Other operating expenses | 7,807,314 | 9,067,582 | (1,260,268) |
| Total operating expenses | <u>36,833,242</u> | <u>38,973,126</u> | <u>(2,139,884)</u> |
| Operating loss | (804,007) | (1,109,342) | 305,335 |
| Nonoperating expense | <u>(465,172)</u> | <u>(278,714)</u> | <u>(186,458)</u> |
| Change in net assets before discontinued operations | (1,269,179) | (1,388,056) | 118,877 |
| Loss from operations of discontinued component | <u>-0-</u> | <u>(114,552)</u> | <u>114,552</u> |
| Change in net assets | (1,269,179) | (1,502,608) | 233,429 |
| Net assets beginning of year | 18,004,425 | 19,507,033 | (1,502,608) |
| Net assets end of year | <u>\$ 16,735,246</u> | <u>\$ 18,004,425</u> | <u>\$ (1,269,179)</u> |

SOURCES OF REVENUE

During 2009, the Hospital derived substantially all of its revenue from patient service and other related activities. A significant portion of the patient service revenue is from patients that are insured by government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. Revenue from the Medicare and Medicaid programs accounted for approximately 44 percent and 12 percent for 2009, respectively, and 45 percent and 12 percent, respectively, of the Hospital's gross patient revenue for the year ended 2008.

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2009 AND 2008

OPERATING AND FINANCIAL PERFORMANCE

The following section highlights the major financial factors for 2009:

- The Hospital's admissions increased from 1,586 in 2008 to 1,634 in 2009 while the Hospital's adjusted patient days decreased to 18,488 in 2009, compared to 20,065 in 2008.
- The Hospital's net patient service revenue decreased approximately \$1,609,000 during 2009, a 4.4% decrease compared to 2008.
- Operating expenses decreased approximately \$2,140,000 or 5.5%. The Hospital's efforts to reduce expenditures for future capital needs while providing excellent patient service was successful. This reduction of expenses reduced the cost to provide Medicare services and resulted in a significant increase to third-party liability at December 31, 2009. The reduction in Medicare reimbursements; caused by reducing costs to provide those services were less than the overall cost reduction efforts and the hospital did receive a net benefit by reducing operating expenses.

CAPITAL ASSETS

The change in capital assets is outlined in the following table

| | 2009 | 2008 | Change |
|-------------------------------|----------------------|----------------------|---------------------|
| Land | \$ 742,282 | \$ 746,488 | \$ (4,206) |
| Land improvements | 828,492 | 828,492 | - |
| Buildings and improvements | 27,219,106 | 27,124,052 | 95,054 |
| Equipment | 30,036,462 | 29,624,330 | 412,132 |
| Construction in progress | 450,234 | 572,031 | (121,797) |
| Total capital assets | 59,276,576 | 58,895,393 | \$ 381,183 |
| Less accumulated depreciation | 41,579,943 | 40,305,631 | 1,274,312 |
| Capital assets, net | <u>\$ 17,696,633</u> | <u>\$ 18,589,762</u> | <u>\$ (893,129)</u> |

Capital assets have not been added in a significant capacity during the timeframe the Hospital was restructuring its long-term finances. The Hospital expects to increase space and equipment resources to meet the needs of the community as needed. The Hospital continually evaluates facilities and equipment to ensure that everything is upgraded as necessary.

DUNN MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DECEMBER 31, 2009 AND 2008

DEBT

See the notes to the combined financial statements for disclosure of the use of a bank letter of credit to pay off the 2003 revenue bonds. The Hospital also entered into a Forbearance Agreement with Fifth Third bank, which expired in May 2009. The Hospital then obtained long-term financing through the issuance of Revenue Bonds issued by the Indiana Bond Bank, which are guaranteed by the County. At December 31, 2009, the following are the sources of debt the Hospital has in place.

- Line of credit
- 2009 revenue bonds
- Capital lease obligations

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

ECONOMIC OUTLOOK

Management believes that the health care industry's and the Hospital's operating margins will continue to be under pressure because of changes in payor mix and growth in operating expenses that are in excess of the increases in contractually arranged and legally established payments received for services rendered. Another factor that poses a challenge to management is the increasing competitive market for the delivery of health care services. The ongoing challenge facing the Hospital is to continue to provide quality patient care in this competitive environment, and to attain reasonable rates for the services that are provided while managing costs. The most significant cost factor affecting the Hospital is the increases in labor costs due to the increasing competition for quality health care workers.

CONTACTING THE HOSPITAL'S FINANCIAL MANAGEMENT

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

DUNN MEMORIAL HOSPITAL

COMBINED BALANCE SHEET DECEMBER 31, 2009 (WITH COMPARATIVE COMBINED TOTALS AT DECEMBER 31, 2008)

| | ASSETS | | | |
|---|-----------------------------------|-------------------|------------------------|------------------------|
| | 2009 | | 2008 | |
| | Hospital | Foundation | Total reporting entity | Total reporting entity |
| Current assets | | | | |
| Cash and cash equivalents | \$ 4,076,341 | \$ 9,842 | \$ 4,086,183 | \$ 1,570,951 |
| Current portion of assets whose use is limited | 544,216 | -0- | 544,216 | 3,700,000 |
| Patient accounts receivable, less allowance for uncollectible accounts of \$4,292,748 in 2009 and \$4,229,976 in 2008 | 5,231,734 | -0- | 5,231,734 | 5,351,717 |
| Other receivables | 270,015 | -0- | 270,015 | 223,941 |
| Estimated third-party settlements | -0- | -0- | -0- | 99,947 |
| Other current assets | 1,306,905 | -0- | 1,306,905 | 1,201,378 |
| Total current assets | <u>11,429,211</u> | <u>9,842</u> | <u>11,439,053</u> | <u>12,147,934</u> |
| Assets whose use is limited | | | | |
| Board designated funds | 115,190 | -0- | 115,190 | 112,215 |
| Debt service reserve funds | 1,088,431 | -0- | 1,088,431 | 3,700,000 |
| Total assets whose use is limited | 1,203,621 | -0- | 1,203,621 | 3,812,215 |
| Less current portion of assets whose use is limited | (544,216) | -0- | (544,216) | (3,700,000) |
| Assets whose use is limited net of current portion | 659,406 | -0- | 659,406 | 112,215 |
| Investments | -0- | 412,654 | 412,654 | 334,159 |
| Capital assets | | | | |
| Land | 742,282 | -0- | 742,282 | 746,488 |
| Construction in progress | 450,234 | -0- | 450,234 | 572,031 |
| Depreciable capital assets, net | 16,504,118 | -0- | 16,504,118 | 17,271,243 |
| | 17,696,634 | -0- | 17,696,634 | 18,589,762 |
| Other assets | 1,190,995 | -0- | 1,190,995 | 1,243,082 |
| Total assets | <u>\$ 30,976,245</u> | <u>\$ 422,496</u> | <u>\$ 31,398,741</u> | <u>\$ 32,427,152</u> |
| | LIABILITIES AND NET ASSETS | | | |
| | 2009 | | 2008 | |
| | Hospital | Foundation | Total reporting entity | Total reporting entity |
| Current liabilities | | | | |
| Notes payable | \$ 369,833 | \$ -0- | \$ 369,833 | \$ 673,808 |
| Current portion of capital leases and long-term debt | 564,850 | -0- | 564,850 | 281,228 |
| Accounts payable | 3,111,740 | 1,899 | 3,113,639 | 3,883,694 |
| Salaries, wages and related payables | 1,483,086 | -0- | 1,483,086 | 1,470,654 |
| Estimated third-party settlements | 1,128,923 | -0- | 1,128,923 | -0- |
| Other current liabilities | 370,895 | -0- | 370,895 | 327,240 |
| Total current liabilities | <u>7,029,327</u> | <u>1,899</u> | <u>7,031,226</u> | <u>6,636,624</u> |
| Noncurrent liabilities | | | | |
| Derivative liability | -0- | -0- | -0- | 7,744 |
| Long-term debt | 6,630,000 | -0- | 6,630,000 | 7,020,000 |
| Long-term capital lease | 581,672 | -0- | 581,672 | 418,637 |
| Total noncurrent liabilities | <u>7,211,672</u> | <u>-0-</u> | <u>7,211,672</u> | <u>7,446,381</u> |
| Total liabilities | 14,240,999 | 1,899 | 14,242,898 | 14,083,005 |
| Net assets | | | | |
| Invested in capital assets, net of related debt | 9,920,112 | -0- | 9,920,112 | 10,869,897 |
| Restricted - debt service reserve funds | 1,088,431 | -0- | 1,088,431 | 3,700,000 |
| Unrestricted | 5,726,703 | 420,597 | 6,147,300 | 3,774,250 |
| Total net assets | <u>16,735,246</u> | <u>420,597</u> | <u>17,155,843</u> | <u>18,344,147</u> |
| Total liabilities and net assets | <u>\$ 30,976,245</u> | <u>\$ 422,496</u> | <u>\$ 31,398,741</u> | <u>\$ 32,427,152</u> |

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED BALANCE SHEET DECEMBER 31, 2008

ASSETS

| | Hospital | Foundation | Total reporting entity |
|--|---------------|------------|---------------------------|
| Current Assets | | | |
| Cash and cash equivalents | \$ 1,560,468 | \$ 10,483 | \$ 1,570,951 |
| Current portion of assets whose use is limited | 3,700,000 | -0- | 3,700,000 |
| Patient accounts receivable, less allowance for uncollectible accounts of \$4,229,976 | 5,351,717 | -0- | 5,351,717 |
| Other receivables | 223,941 | -0- | 223,941 |
| Estimated third-party settlements | 99,947 | -0- | 99,947 |
| Other current assets | 1,200,102 | 1,276 | 1,201,378 |
| Total current assets | 12,136,175 | 11,759 | 12,147,934 |
| Assets whose use is limited | | | |
| Board designated funds | 112,215 | -0- | 112,215 |
| Debt service reserve funds | 3,700,000 | -0- | 3,700,000 |
| Total assets whose use is limited | 3,812,215 | -0- | 3,812,215 |
| Less current portion of assets whose use is limited | (3,700,000) | -0- | (3,700,000) |
| Assets whose use is limited net of current portion | 112,215 | -0- | 112,215 |
| Investments | -0- | 334,159 | 334,159 |
| Capital assets | | | |
| Land | 746,488 | -0- | 746,488 |
| Construction in progress | 572,031 | -0- | 572,031 |
| Depreciable capital assets, net | 17,271,243 | -0- | 17,271,243 |
| | 18,589,762 | -0- | 18,589,762 |
| Other Assets | 1,243,082 | -0- | 1,243,082 |
| Total assets | \$ 32,081,234 | \$ 345,918 | \$ 32,427,152 |

LIABILITIES AND NET ASSETS

| | Hospital | Foundation | Total reporting entity |
|--|---------------|------------|---------------------------|
| Current liabilities | | | |
| Notes payable | \$ 673,808 | \$ -0- | \$ 673,808 |
| Current portion of capital leases and long-term debt | 281,228 | -0- | 281,228 |
| Accounts payable | 3,877,498 | 6,196 | 3,883,694 |
| Salaries, wages and related payables | 1,470,654 | -0- | 1,470,654 |
| Other current liabilities | 327,240 | -0- | 327,240 |
| Total current liabilities | 6,630,428 | 6,196 | 6,636,624 |
| Noncurrent Liabilities | | | |
| Derivative liability | 7,744 | -0- | 7,744 |
| Long-term debt | 7,020,000 | -0- | 7,020,000 |
| Long-term capital lease | 418,637 | -0- | 418,637 |
| Total noncurrent liabilities | 7,446,381 | -0- | 7,446,381 |
| Total liabilities | 14,076,809 | 6,196 | 14,083,005 |
| Net Assets | | | |
| Invested in capital assets, net of related debt | 10,869,897 | -0- | 10,869,897 |
| Restricted - debt service reserve funds | 3,700,000 | -0- | 3,700,000 |
| Unrestricted | 3,434,528 | 339,722 | 3,774,250 |
| Total net assets | 18,004,425 | 339,722 | 18,344,147 |
| Total liabilities and net assets | \$ 32,081,234 | \$ 345,918 | \$ 32,427,152 |

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2009 (WITH COMPARATIVE COMBINED TOTALS FOR DECEMBER 31, 2008)

| | 2009 | | | 2008 | |
|---|----------------------|-------------------|-----------------|---------------------------|---------------------------|
| | Hospital | Foundation | Eliminations | Total reporting entity | Total reporting entity |
| Revenue | | | | | |
| Net patient service revenue | \$ 34,803,037 | \$ -0- | \$ -0- | \$ 34,803,037 | \$ 36,411,946 |
| Other | 1,226,198 | 58,670 | (21,698) | 1,263,170 | 1,483,752 |
| Total operating revenue | <u>36,029,235</u> | <u>58,670</u> | <u>(21,698)</u> | <u>36,066,207</u> | <u>37,895,698</u> |
| Operating expenses | | | | | |
| Salaries and wages | 18,005,148 | -0- | -0- | 18,005,148 | 18,917,057 |
| Employee benefits | 4,239,080 | -0- | -0- | 4,239,080 | 4,107,522 |
| Purchased services and professional fees | 4,910,697 | -0- | -0- | 4,910,697 | 4,638,494 |
| Supplies and other | 7,159,613 | 56,308 | (21,698) | 7,194,223 | 8,447,588 |
| Insurance | 647,701 | -0- | -0- | 647,701 | 650,074 |
| Depreciation and amortization | 1,871,003 | -0- | -0- | 1,871,003 | 2,242,471 |
| Total operating expenses | <u>36,833,242</u> | <u>56,308</u> | <u>(21,698)</u> | <u>36,867,852</u> | <u>39,003,206</u> |
| Operating income (loss) from continuing operations | (804,007) | 2,362 | -0- | (801,645) | (1,107,508) |
| Nonoperating income (expenses) | | | | | |
| Investment income | 22,191 | 78,513 | -0- | 100,704 | (31,045) |
| Non-capital contributions | 13,968 | -0- | -0- | 13,968 | 14,294 |
| Gain on disposal of capital assets | 93,518 | -0- | -0- | 93,518 | 4,106 |
| Interest expense | (594,849) | -0- | -0- | (594,849) | (431,740) |
| Total nonoperating income (expenses), net | <u>(465,172)</u> | <u>78,513</u> | <u>-0-</u> | <u>(386,659)</u> | <u>(444,385)</u> |
| Change in net assets before discontinued operations | (1,269,179) | 80,875 | -0- | (1,188,304) | (1,551,893) |
| Loss from operations of discontinued component | <u>-0-</u> | <u>-0-</u> | <u>-0-</u> | <u>-0-</u> | <u>(114,552)</u> |
| Change in net assets | (1,269,179) | 80,875 | -0- | (1,188,304) | (1,666,445) |
| Net assets | | | | | |
| Beginning of year | 18,004,425 | 339,722 | -0- | 18,344,147 | 20,010,592 |
| End of year | <u>\$ 16,735,246</u> | <u>\$ 420,597</u> | <u>\$ -0-</u> | <u>\$ 17,155,843</u> | <u>\$ 18,344,147</u> |

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2008

| | Hospital | Foundation | Eliminations | Total reporting entity |
|---|----------------------|-------------------|-----------------|---------------------------|
| Revenue | | | | |
| Net patient service revenue | \$ 36,411,946 | \$ -0- | \$ -0- | \$ 36,411,946 |
| Other | 1,451,838 | 62,480 | (30,566) | 1,483,752 |
| Total operating revenue | <u>37,863,784</u> | <u>62,480</u> | <u>(30,566)</u> | <u>37,895,698</u> |
| Operating expenses | | | | |
| Salaries and wages | 18,917,057 | -0- | -0- | 18,917,057 |
| Employee benefits | 4,107,522 | -0- | -0- | 4,107,522 |
| Purchased services and professional fees | 4,638,494 | -0- | -0- | 4,638,494 |
| Supplies and other | 8,417,508 | 92,553 | (62,473) | 8,447,588 |
| Insurance | 650,074 | -0- | -0- | 650,074 |
| Depreciation and amortization | 2,242,471 | -0- | -0- | 2,242,471 |
| Total operating expenses | <u>38,973,126</u> | <u>92,553</u> | <u>(62,473)</u> | <u>39,003,206</u> |
| Operating loss from continuing operations | (1,109,342) | (30,073) | 31,907 | (1,107,508) |
| Nonoperating income (expenses) | | | | |
| Investment income | 102,719 | (133,764) | -0- | (31,045) |
| Non-capital contributions | 46,201 | -0- | (31,907) | 14,294 |
| Gain on disposal of capital assets | 4,106 | -0- | -0- | 4,106 |
| Interest expense | (431,740) | -0- | -0- | (431,740) |
| Total nonoperating income (expenses), net | <u>(278,714)</u> | <u>(133,764)</u> | <u>(31,907)</u> | <u>(444,385)</u> |
| Change in net assets before discontinued operations | (1,388,056) | (163,837) | -0- | (1,551,893) |
| Loss from operations of discontinued component | <u>(114,552)</u> | <u>-0-</u> | <u>-0-</u> | <u>(114,552)</u> |
| Change in net assets | (1,502,608) | (163,837) | -0- | (1,666,445) |
| Net assets | | | | |
| Beginning of year | 19,507,033 | 503,559 | -0- | 20,010,592 |
| End of year | <u>\$ 18,004,425</u> | <u>\$ 339,722</u> | <u>\$ -0-</u> | <u>\$ 18,344,147</u> |

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENT OF CASH FLOWS YEAR ENDED DECEMBER 31, 2009 (WITH COMPARATIVE COMBINED TOTALS FOR DECEMBER 31, 2008)

| | 2009 | | | 2008 | |
|--|---------------------|-----------------|---------------|---------------------------|---------------------------|
| | Hospital | Foundation | Eliminations | Total reporting entity | Total reporting entity |
| Operating activities | | | | | |
| Cash received from patient services | \$ 36,151,890 | \$ -0- | \$ -0- | \$ 36,151,890 | \$ 39,349,192 |
| Cash paid for salaries, wages and benefits | (22,231,796) | -0- | -0- | (22,231,796) | (22,954,280) |
| Cash paid to vendors and suppliers | (13,113,240) | (59,329) | -0- | (13,172,569) | (13,666,045) |
| Other receipts and payments, net | 622,391 | 58,670 | -0- | 681,061 | 1,605,786 |
| Net cash flows from operating activities | <u>1,429,245</u> | <u>(659)</u> | <u>-0-</u> | <u>1,428,586</u> | <u>4,334,653</u> |
| Non-capital financing activities | | | | | |
| Non-capital contributions | 13,968 | -0- | -0- | 13,968 | 14,294 |
| Net cash flows from non-capital financing activities | <u>13,968</u> | <u>-0-</u> | <u>-0-</u> | <u>13,968</u> | <u>14,294</u> |
| Capital and related financing activities | | | | | |
| Proceeds from note payable | -0- | -0- | -0- | -0- | 7,630,000 |
| Payments on note payable | (303,975) | -0- | -0- | (303,975) | (434,891) |
| Proceeds from long-term debt | -0- | -0- | -0- | -0- | 13,020 |
| Payments on long-term debt | (466,374) | -0- | -0- | (466,374) | (7,659,546) |
| Interest on long-term debt | (600,528) | -0- | -0- | (600,528) | (428,305) |
| Proceeds from the sale of capital assets | 101,966 | -0- | -0- | 101,966 | 8,100 |
| Loss from discontinued operations | -0- | -0- | -0- | -0- | (114,552) |
| Purchase of capital assets | (287,149) | -0- | -0- | (287,149) | (1,338,488) |
| Net cash flows from capital and related financing activities | <u>(1,556,060)</u> | <u>-0-</u> | <u>-0-</u> | <u>(1,556,060)</u> | <u>(2,324,662)</u> |
| Investing activities | | | | | |
| Investment income (loss) | 22,191 | 78,513 | -0- | 100,704 | (31,045) |
| Other changes in assets whose use is limited and investments | (5,040) | (78,495) | -0- | (83,535) | 157,340 |
| Net cash flows from investing activities | <u>17,151</u> | <u>18</u> | <u>-0-</u> | <u>17,169</u> | <u>126,295</u> |
| Net change in cash and cash equivalents | <u>(95,696)</u> | <u>(641)</u> | <u>-0-</u> | <u>(96,337)</u> | <u>2,150,580</u> |
| Cash and cash equivalents | | | | | |
| Beginning of year | 5,260,468 | 10,483 | -0- | 5,270,951 | 3,120,371 |
| End of year | <u>\$ 5,164,772</u> | <u>\$ 9,842</u> | <u>\$ -0-</u> | <u>\$ 5,174,614</u> | <u>\$ 5,270,951</u> |
| Reconciliation of cash and cash equivalents to the balance sheets | | | | | |
| Cash and cash equivalents | | | | | |
| In current assets | \$ 4,076,341 | \$ 9,842 | \$ -0- | \$ 4,086,183 | \$ 1,570,951 |
| In assets whose use is limited | 1,088,431 | -0- | -0- | 1,088,431 | 3,700,000 |
| Total cash and cash equivalents | <u>\$ 5,164,772</u> | <u>\$ 9,842</u> | <u>\$ -0-</u> | <u>\$ 5,174,614</u> | <u>\$ 5,270,951</u> |

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENT OF CASH FLOWS YEAR ENDED DECEMBER 31, 2009 (WITH COMPARATIVE COMBINED TOTALS FOR DECEMBER 31, 2008)

| | 2009 | | | 2008 | |
|---|---------------------|-----------------|---------------|---------------------------|---------------------------|
| | Hospital | Foundation | Eliminations | Total reporting entity | Total reporting entity |
| Reconciliation of operating income (loss) to net cash flows from operating activities | | | | | |
| Operating income (loss) from continuing operations | \$ (804,007) | \$ 2,362 | \$ -0- | \$ (801,645) | \$ (1,107,508) |
| Adjustments to reconcile operating income (loss) from continuing operations to net cash flows from operating activities | | | | | |
| Depreciation and amortization | 1,871,003 | -0- | -0- | 1,871,003 | 2,242,471 |
| Provision for bad debts | 4,023,591 | -0- | -0- | 4,023,591 | 4,538,755 |
| Changes in operating assets and liabilities | | | | | |
| Patient accounts receivable | (3,903,608) | -0- | -0- | (3,903,608) | (2,776,556) |
| Other receivables | (46,074) | -0- | -0- | (46,074) | (8,374) |
| Estimated third-party payor settlements | 1,228,870 | -0- | -0- | 1,228,870 | 1,175,047 |
| Other current assets | (106,803) | 1,276 | -0- | (105,527) | 207,253 |
| Other assets | (124,056) | -0- | -0- | (124,056) | (170,847) |
| Accounts payable | (765,758) | (4,297) | -0- | (770,055) | 288,736 |
| Salaries, wages and related payable | 12,432 | -0- | -0- | 12,432 | 70,299 |
| Other current liabilities | 43,655 | -0- | -0- | 43,655 | (124,623) |
| Net cash flows from operating activities | <u>\$ 1,429,245</u> | <u>\$ (659)</u> | <u>\$ -0-</u> | <u>\$ 1,428,586</u> | <u>\$ 4,334,653</u> |
| Supplemental cash flows information | | | | | |
| Cash paid for interest | \$ 600,528 | \$ -0- | \$ -0- | \$ 600,528 | \$ 428,305 |
| Noncash capital and related financing activities | | | | | |
| Capital lease obligation incurred for use of equipment | \$ 523,031 | \$ -0- | \$ -0- | \$ 523,031 | \$ 75,000 |
| Change in other assets - physician loans and guarantees | \$ 433,677 | \$ -0- | \$ -0- | \$ 433,677 | \$ (170,098) |

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENT OF CASH FLOWS YEAR ENDED DECEMBER 31, 2008

| | Hospital | Foundation | Eliminations | Total reporting entity |
|--|---------------|------------|--------------|---------------------------|
| Operating activities | | | | |
| Cash received from patient services | \$ 39,349,192 | \$ -0- | \$ -0- | \$ 39,349,192 |
| Cash paid for salaries, wages and benefits | (22,954,280) | -0- | -0- | (22,954,280) |
| Cash paid to vendors and suppliers | (13,574,077) | (91,968) | -0- | (13,666,045) |
| Other receipts and payments, net | 1,511,399 | 62,480 | 31,907 | 1,605,786 |
| Net cash flows from operating activities | 4,332,234 | (29,488) | 31,907 | 4,334,653 |
| Non-capital financing activities | | | | |
| Non-capital contributions | 46,201 | -0- | (31,907) | 14,294 |
| Net cash flows from non-capital financing activities | 46,201 | -0- | (31,907) | 14,294 |
| Capital and related financing activities | | | | |
| Proceeds from note payable | 7,630,000 | -0- | -0- | 7,630,000 |
| Payments on note payable | (434,891) | -0- | -0- | (434,891) |
| Proceeds from long-term debt | 13,020 | -0- | -0- | 13,020 |
| Payments on long-term debt | (7,659,546) | -0- | -0- | (7,659,546) |
| Interest on long-term debt | (428,305) | -0- | -0- | (428,305) |
| Proceeds from the sale of capital assets | 8,100 | -0- | -0- | 8,100 |
| Loss from discontinued operations | (114,552) | -0- | -0- | (114,552) |
| Purchase of capital assets | (1,338,488) | -0- | -0- | (1,338,488) |
| Net cash flows from capital and related financing activities | (2,324,662) | -0- | -0- | (2,324,662) |
| Investing activities | | | | |
| Investment income | 102,719 | (133,764) | -0- | (31,045) |
| Other changes in assets whose use is limited and investments | (815) | 158,155 | -0- | 157,340 |
| Net cash flows from investing activities | 101,904 | 24,391 | -0- | 126,295 |
| Net change in cash and cash equivalents | 2,155,677 | (5,097) | -0- | 2,150,580 |
| Cash and cash equivalents | | | | |
| Beginning of year | 3,104,791 | 15,580 | -0- | 3,120,371 |
| End of year | \$ 5,260,468 | \$ 10,483 | \$ -0- | \$ 5,270,951 |
| Reconciliation of cash and cash equivalents to the balance sheets | | | | |
| Cash and cash equivalents | | | | |
| In current assets | \$ 1,560,468 | \$ 10,483 | \$ -0- | \$ 1,570,951 |
| In assets whose use is limited | 3,700,000 | -0- | -0- | 3,700,000 |
| Total cash and cash equivalents | \$ 5,260,468 | \$ 10,483 | \$ -0- | \$ 5,270,951 |

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

COMBINED STATEMENT OF CASH FLOWS YEAR ENDED DECEMBER 31, 2008

| | Hospital | Foundation | Eliminations | Total reporting entity |
|--|----------------|-------------|--------------|---------------------------|
| Reconciliation of operating income to net cash flows from operating activities | | | | |
| Operating loss from continuing operations | \$ (1,109,342) | \$ (30,073) | \$ 31,907 | \$ (1,107,508) |
| Adjustments to reconcile operating loss from continuing operations to net cash flows from operating activities | | | | |
| Depreciation and amortization | 2,242,471 | -0- | -0- | 2,242,471 |
| Provision for bad debts | 4,538,755 | -0- | -0- | 4,538,755 |
| Changes in operating assets and liabilities | | | | |
| Patient accounts receivable | (2,776,556) | -0- | -0- | (2,776,556) |
| Other receivables | (8,374) | -0- | -0- | (8,374) |
| Estimated third-party payor settlements | 1,175,047 | -0- | -0- | 1,175,047 |
| Other current assets | 201,607 | 5,646 | -0- | 207,253 |
| Other assets | (170,847) | -0- | -0- | (170,847) |
| Accounts payable | 293,797 | (5,061) | -0- | 288,736 |
| Salaries, wages and related payable | 70,299 | -0- | -0- | 70,299 |
| Other current liabilities | (124,623) | -0- | -0- | (124,623) |
| Net cash flows from operating activities | \$ 4,332,234 | \$ (29,488) | \$ 31,907 | \$ 4,334,653 |
| Supplemental cash flows information | | | | |
| Cash paid for interest | \$ 428,305 | \$ -0- | \$ -0- | \$ 428,305 |
| Noncash capital and related financing activities | | | | |
| Capital lease obligation incurred for use of equipment | \$ 75,000 | \$ -0- | \$ -0- | \$ 75,000 |
| Change in other assets - physician loans and guarantees | \$ (170,098.0) | \$ -0- | \$ -0- | \$ (170,098) |

See accompanying notes to combined financial statements.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

1. SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

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

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

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

Discrete Component Unit

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

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

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Use of Estimates

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

Enterprise Fund Accounting

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

Risk Management

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

Cash and Cash Equivalents

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

Investments

Investments are reported at fair value, as determined by quoted market prices. Interest, dividends, and gains and losses, both realized and unrealized, on investments are included in nonoperating revenue when earned.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Patient Accounts Receivable and Net Patient Service Revenue

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

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

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

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

Advertising

The Hospital expenses advertising costs as they are incurred. Advertising expenses for the years ended December 31, 2009 and 2008 were \$155,676 and \$191,586, respectively.

Inventories

Inventories consist mainly of medical, pharmaceutical and dietary supplies and are stated at the lower of cost, using the first-in, first-out (FIFO) method or market.

Assets Whose Use is Limited and Investments

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

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Assets whose use is limited are stated at contract value, which approximates fair value in the combined financial statements. These assets include investments designated by the Hospital Board for internal purposes and investments held by trustees for capital improvements and debt service. These investments consist primarily of cash and cash equivalents and certificates of deposit. Investment income, to the extent not capitalized, is reported as nonoperating income in the combined statements of revenues, expenses and changes in net assets.

Capital Assets

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

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

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

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

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

Costs of Borrowing

Except for capital assets acquired through gifts, contributions or capital grants, interest cost on borrowed funds, as well as interest earned on those funds, during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. There was no capitalized interest in 2009 and 2008.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Deferred Financing Costs

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

Compensated Absences

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

Net Assets

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

Grants and Contributions

From time to time, the reporting entity receives contributions from individuals and private organizations. Revenues from contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted for a specific operating purpose are reported as non-operating revenues. Amounts restricted for capital acquisitions are reported after non-operating revenues and expenses.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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.

Operating Revenues and Expenses

The reporting entity's combined statements of revenues, expenses and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

Physician Loans and Guarantees

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

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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

The total amount of the physician loans and guarantees, which are included in other assets, is \$632,513 and \$1,066,190 as of December 31, 2009 and 2008, respectively.

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through May 28, 2010.

Reclassifications

Certain amounts from 2008 have been reclassified in order to conform to the current year presentation.

2. NET PATIENT SERVICE REVENUE

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

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

Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates. In connection with the Indiana Medicaid program, the Hospital receives additional funding through the Hospital Care for the Indigent, the Medicaid Disproportionate Share (DSH), and the Upper Payment Limit (UPL) programs. These payments are received by the Hospital on a periodic basis. Related to the DSH and UPL programs, the Hospital recognized revenue of approximately \$2,100,000 for the years ended December 31, 2009 and 2008, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates. The following is a summary of net patient service revenue for the years ended December 31, 2009 and 2008:

| | <u>2009</u> | <u>2008</u> |
|-------------------------------|-----------------------------|-----------------------------|
| Inpatient service revenue | \$ 21,263,262 | \$ 20,775,736 |
| Outpatient service revenue | <u>50,100,834</u> | <u>48,919,422</u> |
| Gross patient service revenue | 71,364,096 | 69,695,158 |
| | | |
| Contractual allowance | 31,662,245 | 27,690,864 |
| Charity care | 875,223 | 1,053,593 |
| Bad debts | <u>4,023,591</u> | <u>4,538,755</u> |
| Deductions from revenue | <u>36,561,059</u> | <u>33,283,212</u> |
| | | |
| Net patient service revenue | <u><u>\$ 34,803,037</u></u> | <u><u>\$ 36,411,946</u></u> |

3. CHARITY CARE

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of services and supplies furnished under its charity care policy. The charity care provided during 2009 and 2008 was \$875,223 and \$1,053,593, respectively.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

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.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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.

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

| | Total | Quoted market prices for identical assets Level 1 | Significant other observable inputs Level 2 | Significant unobservable inputs Level 3 |
|-------------------------|------------|--|--|--|
| Foundation | | | | |
| Investments | | | | |
| Mutual funds | \$ 233,256 | \$ 233,256 | \$ -0- | \$ -0- |
| Equities | 161,502 | 161,502 | -0- | -0- |
| Fixed Income Securities | 8,592 | -0- | 8,592 | -0- |
| | 403,350 | \$ 394,758 | \$ 8,592 | \$ -0- |
| Cash and equivalents | 9,304 | | | |
| Total investments | \$ 412,654 | | | |

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

| | Total | Quoted market prices for identical assets Level 1 | Significant other observable inputs Level 2 | Significant unobservable inputs Level 3 |
|-------------------------|------------|--|--|--|
| Hospital | | | | |
| Liabilities | | | | |
| Derivative Liability | \$ 7,744 | \$ -0- | \$ 7,744 | \$ -0- |
| Foundation | | | | |
| Investments | | | | |
| Mutual funds | \$ 188,178 | \$ 188,178 | \$ -0- | \$ -0- |
| Equities | 129,347 | 129,347 | -0- | -0- |
| Fixed Income Securities | 13,522 | -0- | 13,522 | -0- |
| | 331,047 | \$ 317,525 | \$ 13,522 | \$ -0- |
| Cash and equivalents | 3,112 | | | |
| Total investments | \$ 334,159 | | | |

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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

Cash and cash equivalents, accounts payable, accrued expenses and estimated third-party settlements: The carrying amount reported in the balance sheets for cash and cash equivalents, accounts payable, accrued expenses and estimated third-party settlements approximate fair value.

Debt and Capital Leases: The carrying amount reported in the balance sheets for debt and capital leases approximates fair value.

5. DEPOSITS, INVESTMENTS AND INVESTMENT INCOME

Deposits with financial institutions in the State of Indiana at year-end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution. The reporting entity's investments generally are reported at fair value, as discussed in Note 1. As of December 31, 2009 and 2008, the Hospital had the following investments and maturities, all of which were held in the Hospital's name by custodial banks that are agents of the Hospital.

December 31, 2009

| | Carrying amount | Investment Maturities (in Years) | | | |
|-------------------------|-------------------|----------------------------------|---------------|---------------|-----------------|
| | | Less than 1 | 1 - 5 | 6 - 10 | More than 10 |
| Hospital | | | | | |
| Certificates of Deposit | \$ 115,190 | \$ 115,190 | \$ -0- | \$ -0- | \$ -0- |
| Foundation | | | | | |
| Money market funds | \$ 9,304 | \$ 9,304 | \$ -0- | \$ -0- | \$ -0- |
| Mutual funds | 233,256 | 233,256 | -0- | -0- | -0- |
| Equities | 161,502 | 161,502 | -0- | -0- | -0- |
| Fixed income securities | 8,592 | -0- | -0- | -0- | 8,592 |
| | <u>\$ 412,654</u> | <u>\$ 404,062</u> | <u>\$ -0-</u> | <u>\$ -0-</u> | <u>\$ 8,592</u> |

December 31, 2008

| | Carrying amount | Investment Maturities (in Years) | | | |
|-------------------------|-------------------|----------------------------------|-----------------|---------------|-----------------|
| | | Less than 1 | 1 - 5 | 6 - 10 | More than 10 |
| Hospital | | | | | |
| Certificates of Deposit | \$ 112,215 | \$ 112,215 | \$ -0- | \$ -0- | \$ -0- |
| Foundation | | | | | |
| Money market funds | \$ 3,112 | \$ 3,112 | \$ -0- | \$ -0- | \$ -0- |
| Mutual funds | 188,178 | 188,178 | -0- | -0- | -0- |
| Equities | 129,347 | 129,347 | -0- | -0- | -0- |
| Fixed income securities | 13,522 | -0- | 5,002 | -0- | 8,520 |
| | <u>\$ 334,159</u> | <u>\$ 320,637</u> | <u>\$ 5,002</u> | <u>\$ -0-</u> | <u>\$ 8,520</u> |

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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

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

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

Deposits and investments consisted of the following as of December 31, 2009 and 2008:

| | | |
|--|---------------------|---------------------|
| Hospital | | |
| Carrying amount | | |
| Deposits | \$ 5,164,772 | \$ 5,260,468 |
| Investments | 115,190 | 112,215 |
| | <u>\$ 5,279,962</u> | <u>\$ 5,372,683</u> |
| Included in the following balance sheet captions | | |
| Cash and cash equivalents | \$ 4,076,341 | \$ 1,560,468 |
| Debt service reserve funds | 1,088,431 | 3,700,000 |
| Board designated | 115,190 | 112,215 |
| | <u>\$ 5,279,962</u> | <u>\$ 5,372,683</u> |
| Foundation | | |
| Carrying amount | | |
| Deposits | \$ 9,842 | \$ 10,483 |
| Investments | 412,654 | 334,159 |
| | <u>\$ 422,496</u> | <u>\$ 344,642</u> |
| Included in the following balance sheet captions | | |
| Cash and cash equivalents | \$ 9,842 | \$ 10,483 |
| Investments | 412,654 | 334,159 |
| | <u>\$ 422,496</u> | <u>\$ 344,642</u> |

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

6. ACCOUNTS RECEIVABLE AND PAYABLE

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at December 31, 2009 and 2008, consisted of the following amounts:

| | <u>2009</u> | <u>2008</u> |
|---|---------------------|---------------------|
| <u>Patient accounts receivable</u> | | |
| Hospital | | |
| Receivable from patients and their insurance carriers | \$ 9,305,058 | \$ 9,556,760 |
| Receivable from Medicare | 2,292,559 | 2,358,106 |
| Receivable from Medicaid | 1,205,329 | 1,165,394 |
| Total patient accounts receivable | <u>12,802,946</u> | <u>13,080,260</u> |
| Less allowance for contractual agreements and uncollectible amounts | <u>7,571,212</u> | <u>7,728,543</u> |
| Patient accounts receivable, net | <u>\$ 5,231,734</u> | <u>\$ 5,351,717</u> |
| | | |
| <u>Accounts payable and accrued expenses</u> | | |
| Hospital | | |
| Payable to suppliers and other | \$ 3,111,740 | \$ 3,883,694 |
| Payable to employees (including payroll taxes and benefits) | 1,483,086 | 1,470,654 |
| Other payables | 370,895 | 324,240 |
| Total accounts payable and accrued expenses | <u>\$ 4,965,721</u> | <u>\$ 5,678,588</u> |
| | | |
| Foundation | | |
| Payable to suppliers | <u>\$ 1,899</u> | <u>\$ 6,196</u> |

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

7. CAPITAL ASSETS

A summary of capital assets at December 31, 2009 and 2008 is as follows:

| | Balance December 31, 2008 | Additions | Retirements & Transfers | Balance December 31, 2009 |
|--------------------------------------|---------------------------------|---------------------|----------------------------|---------------------------------|
| Hospital | | | | |
| Land | \$ 746,488 | \$ -0- | \$ (4,206) | \$ 742,282 |
| Land improvements | 828,492 | -0- | -0- | 828,492 |
| Buildings and improvements | 27,124,052 | 56,114 | 38,940 | 27,219,106 |
| Equipment | 29,624,330 | 761,113 | (348,980) | 30,036,463 |
| Construction in progress | 572,031 | -0- | (121,797) | 450,234 |
| Total capital assets | <u>58,895,393</u> | <u>817,227</u> | <u>(436,043)</u> | <u>59,276,577</u> |
| Less accumulated depreciation | | | | |
| Land improvements | 660,131 | 22,935 | -0- | 683,066 |
| Buildings and improvements | 13,739,859 | 754,377 | (38,297) | 14,455,939 |
| Equipment | 25,905,641 | 884,277 | (348,980) | 26,440,938 |
| Total accumulated depreciation | <u>40,305,631</u> | <u>1,661,589</u> | <u>(387,277)</u> | <u>41,579,943</u> |
| Hospital capital assets, net | <u>\$ 18,589,762</u> | <u>\$ (844,362)</u> | <u>\$ (48,766)</u> | <u>\$ 17,696,634</u> |

| | Balance December 31, 2007 | Additions | Retirements & Transfers | Balance December 31, 2008 |
|--------------------------------------|---------------------------------|---------------------|----------------------------|---------------------------------|
| Hospital | | | | |
| Land | \$ 750,982 | \$ -0- | \$ (4,494) | \$ 746,488 |
| Land improvements | 825,755 | 2,737 | -0- | 828,492 |
| Buildings and improvements | 26,293,486 | 198,350 | 632,216 | 27,124,052 |
| Equipment | 29,225,040 | 399,290 | -0- | 29,624,330 |
| Construction in progress | 402,687 | 801,560 | (632,216) | 572,031 |
| Total capital assets | <u>57,497,950</u> | <u>1,401,937</u> | <u>(4,494)</u> | <u>58,895,393</u> |
| Less accumulated depreciation | | | | |
| Land improvements | 637,201 | 22,930 | -0- | 660,131 |
| Buildings and improvements | 12,964,022 | 775,837 | -0- | 13,739,859 |
| Equipment | 24,485,731 | 1,419,910 | -0- | 25,905,641 |
| Total accumulated depreciation | <u>38,086,954</u> | <u>2,218,677</u> | <u>-0-</u> | <u>40,305,631</u> |
| Hospital capital assets, net | <u>\$ 19,410,996</u> | <u>\$ (816,740)</u> | <u>\$ (4,494)</u> | <u>\$ 18,589,762</u> |

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

8. NOTES PAYABLE

The Hospital periodically borrows funds from banks to finance certain operating expenses. The note payable bears interest at 2% above the prime rate 5.94% at December 31, 2009), is unsecured and matures December 1, 2010.

The Hospital also held a short-term loan with a bank related to a forbearance agreement during 2008, which was subsequently refinanced to long-term debt. See Note 9 for further details related to the re-financing.

The following is a summary of the short-term note payable to bank activity for the years ended December 31, 2009 and 2008:

| | Balance December 31, 2008 | Additional Borrowings | Payments | Subsequent Refinancing | Balance December 31, 2009 |
|---------------|---------------------------------|--------------------------|------------|---------------------------|---------------------------------|
| Notes payable | \$ 673,808 | \$ -0- | \$ 303,975 | \$ -0- | \$ 369,833 |

| | Balance December 31, 2007 | Additional Borrowings | Payments | Subsequent Refinancing | Balance December 31, 2008 |
|---------------|---------------------------------|--------------------------|------------|---------------------------|---------------------------------|
| Notes payable | \$ 498,699 | \$ 7,630,000 | \$ 434,891 | \$ (7,020,000) | \$ 673,808 |

9. LONG-TERM OBLIGATIONS

The following is a summary of long-term obligation transactions for the Hospital for the years ended December 31, 2009 and 2008:

| | Balance December 31, 2008 | Additional Borrowings | Payments | Subsequent Refinancing | Balance December 31, 2009 | Current Portion | Total Long-Term Debt |
|---------------------------|---------------------------------|--------------------------|-------------------|---------------------------|---------------------------------|--------------------|----------------------------|
| Revenue bonds payable | \$ 7,020,000 | \$ -0- | \$ 150,000 | \$ -0- | \$ 6,870,000 | \$ 240,000 | \$ 6,630,000 |
| Capital lease obligations | 699,865 | 523,031 | 316,374 | -0- | 906,522 | 324,850 | 581,672 |
| | <u>\$ 7,719,865</u> | <u>\$ 523,031</u> | <u>\$ 466,374</u> | <u>\$ 7,020,000</u> | <u>\$ 7,776,522</u> | <u>\$ 564,850</u> | <u>\$ 7,211,672</u> |

| | Balance December 31, 2007 | Additional Borrowings | Payments | Subsequent Refinancing | Balance December 31, 2008 | Current Portion | Total Long-Term Debt |
|---------------------------|---------------------------------|--------------------------|---------------------|---------------------------|---------------------------------|--------------------|----------------------------|
| Revenue bonds payable | \$ 7,205,000 | \$ -0- | \$ 7,205,000 | \$ 7,020,000 | \$ 7,020,000 | \$ -0- | \$ 7,020,000 |
| Capital lease obligations | 1,066,391 | 75,000 | 441,526 | -0- | 699,865 | 281,228 | 418,637 |
| | <u>\$ 8,271,391</u> | <u>\$ 75,000</u> | <u>\$ 7,646,526</u> | <u>\$ -0-</u> | <u>\$ 7,719,865</u> | <u>\$ 281,228</u> | <u>\$ 7,438,637</u> |

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

2003 Revenue Bonds Payable

The revenue bonds payable consisted of health facility bonds in an original amount of \$8,365,000 dated November 18, 2003. Interest was due monthly at a defined weekly variable rate and the bond payments were made annually on November 1. The Hospital had entered into an interest rate swap, which is more fully described in Note 10. The bonds were secured by an irrevocable letter of credit dated November 19, 2003, which expired in 2008. The bond was called when the letter of credit expired and the bond was paid in full with a draw on the letter of credit in the approximate amount of \$7,200,000.

Forbearance Agreement

A Forbearance Agreement was signed by the Hospital and a bank in December 2008. The agreement expired May 31, 2009.

The related Reimbursement Obligation was secured by substantially all of the assets of the Hospital. Interest was paid monthly at a rate of prime plus 5%.

The bank required \$3.7 Million to be held in a debt service reserve fund to pay the fees and payments required by the agreement during the entire Forbearance Period. The funds were used to pay legal fees, one payment of the reimbursement obligation and accrued interest. The Hospital violated specific conditions on their forbearance agreement with the Bank and the full \$3.7 Million was withdrawn and used to pay the above amounts with the remaining portion paid directly on the reimbursement obligation.

2009 Revenue Bonds Payable

The Hospital obtained long-term financing as is described herein during 2009. The Indiana Bond Bank (the "Bond Bank") issued tax-exempt Special Program Bonds, Series 2009B-1(Dunn Memorial Hospital Project) in the amount of \$4,040,000 and Taxable Special Program Bonds, Series 2009B-2 (Dunn Memorial Hospital Project) in the amount of \$2,980,000 in 2009 pursuant to the provisions of a Trust Indenture with the Trustee, UMB Bank, N.A. Indianapolis, Indiana in the aggregate principal amount of \$7,020,000. The Series 2009B-1 and the Series 2009B-2 Bonds shall be referred to collectively as the Series 2009 Bonds.

The Bond Bank is the obligor to the bondholders. The bonds are insured. The Series 2009 Bonds are issued by the Bond Bank for the principle purposes of (a) providing funds for the purchase of certain Series 2009 Qualified Obligations of the Qualified Entity (The Lawrence County Hospital Association), (b) funding the Reserve Requirement of the Debt Service Reserve Funds and (c) paying costs related to the issuance of the Series 2009 Bonds.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

The Series 2009 Bonds have interest rates ranging from 1.5% to 6.375% to be paid annually through February 1, 2029. Certain Series 2009 Bonds are subject to extraordinary mandatory redemption prior to maturity including upon the sale of all or substantially all of the Premises as defined.

The Lawrence County Hospital Association (the "Association") was created under the Indiana Code and is authorized to enter into leases with a county in order to provide funds to finance, acquire, renovate, equip and lease land and buildings. As the Qualified Entity, the Association issued Lease Rental Revenue Bonds, Series 2009B and Taxable Lease Rental Revenue Bonds, Series 2009C. The Series 2009B Qualified Obligations and the Series 2009C Qualified Obligations, collectively referred to as the Series 2009 Qualified Obligations were issued pursuant to a Trust Indenture in 2009 between the Association and the Trustee.

The Series 2009 Qualified Obligations are payable from lease rental revenues received by the Qualified Entity as lessor, from Lawrence County, Indiana, acting through its Board of Commissioners and the Board of Trustees of Dunn Memorial Hospital as lessees (collectively, the "Lessee") under a lease agreement entered into in 2009 for certain Hospital additions and improvements (the "Leased Premises").

Pursuant to the Lease, the Lessee has agreed to make payments directly to the Trustee in such amounts and at such times as are sufficient to pay in full, when due, the principal and interest of the Series 2009 Qualified Obligations. The County and the Hospital anticipate that the full lease rental payments will be paid from Hospital revenues. The lease rental revenues are pledged to secure the Series 2009 Qualified Obligations. In addition to the Lease, the Series 2009 Qualified Obligations are secured by certain property taxes that could be appropriated and/or levied by the County as is defined in the agreement.

The Series 2009 Qualified Obligations and the Lease have essentially the same terms with interest rates ranging from 1.5% to 6.375% with interest plus a fixed amount of principle as determined in the agreements, to be paid semi-annually on January 15 and July 15 with final maturity on January 15, 2029. The net proceeds on the Series 2009 Qualified Obligations among other purposes were used to refinance certain debt obligations including the conduit financing that replaced the 2003 Revenue Bonds, to fund the required debt service reserve funds, and to re-finance other existing obligations. The Trust Indenture has certain compliance requirements for which the Hospital believes it is in compliance.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. The capital lease obligations have varying imputed interest rates of 2.1% to 10%, expiring through October 2014. Capital leases are collateralized by leased equipment with a cost of approximately \$1,600,000 million and \$1,700,000 million at December 31, 2009 and 2008, respectively. Accumulated depreciation on capital leases was approximately \$992,000, and \$814,000 at December 31, 2009 and 2008, respectively.

Scheduled principal and interest repayments on long-term debt and capital lease obligations are as follows:

| Year Ending December 31, | Long-term Debt | | Capital Lease Obligations | |
|-----------------------------|----------------|--------------|---------------------------|------------|
| | Principal | Interest | Principal | Interest |
| 2010 | \$ 240,000 | \$ 327,364 | \$ 324,850 | \$ 53,854 |
| 2011 | 255,000 | 320,781 | 267,864 | 31,371 |
| 2012 | 260,000 | 313,231 | 163,475 | 16,787 |
| 2013 | 265,000 | 305,231 | 81,043 | 8,524 |
| 2014 | 280,000 | 296,089 | 69,290 | 2,441 |
| 2015-2019 | 1,565,000 | 1,297,669 | -0- | -0- |
| 2020-2024 | 1,980,000 | 878,684 | -0- | -0- |
| 2025-2029 | 2,025,000 | 263,727 | -0- | -0- |
| | \$ 6,870,000 | \$ 4,002,776 | \$ 906,522 | \$ 112,977 |

10. DERIVATIVE FINANCIAL INSTRUMENTS - INTEREST RATE SWAP

From time to time, the Hospital makes limited use of derivative financial instruments for the purpose of managing interest rate risk. In particular, forward interest rate swaps (which are designated as cash flow hedges) are used to manage the risk associated with interest rates on variable-rate borrowings and to lower its overall borrowing costs.

During 2009, the Hospital had outstanding one interest rate swap agreement with a financial institution, having a total principal amount of \$4,000,000. The agreement expired in February 2009. The agreement effectively changed the Hospital's interest rate exposure on its Variable Rate Demand Revenue Bonds Series 2003 originally due 2023 to a fixed 2.893%. The Hospital was exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreements. However, the Hospital was not exposed by nonperformance by the counterparties.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

The derivative is not designated as a hedging instrument, and is marked-to-market on the balance sheet at fair value. The related gains and losses are included in excess revenue and gains over expenses and losses, the performance indicator, for the reporting period. Cash flows from interest rate swap contracts are classified as an operating activity on the statement of cash flows.

The asset derivatives are reported in the balance sheets as other assets and liability derivatives are reported as derivative liabilities.

As of December 31, 2009 and 2008, the fair values of derivatives recorded in the balance sheets are as follows:

| | 2009 | 2008 |
|----------------------|--------|----------|
| Derivative liability | \$ -0- | \$ 7,744 |

During 2009 and 2008, the amount of gain or loss recognized in the statement of operations and reported as a component of nonoperating income (expenses) is as follows:

| | 2009 | 2008 |
|-----------------------------------|----------|------------|
| Derivative unrealized gain (loss) | \$ 5,679 | \$ (3,435) |

Additional information regarding fair value measurements of the interest rate swap agreements is disclosed in Note 9.

11. PENSION PLAN

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. Employer contributions to the plan were \$575,850 and \$697,028 for 2009 and 2008, respectively.

12. COMMITMENTS AND CONTINGENCIES

Operating leases - lessee

The Hospital is committed under non-cancelable operating leases for equipment. The leases expire through 2013. Total rent expense for 2009 and 2008 was \$270,217 and \$216,817, respectively.

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

The following is a schedule of future minimum lease payments under operating leases as of December 31, 2009, that have initial or remaining lease terms in excess of one year:

| Year ending December 31, | | |
|-----------------------------|-----------|----------------|
| 2010 | \$ | 92,267 |
| 2011 | | 45,660 |
| 2012 | | 45,660 |
| 2013 | | 26,635 |
| | <u>\$</u> | <u>210,222</u> |

Litigation

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

13. CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Accounts receivable and revenues from self-pay and third-party payors were as follows:

| | Receivables | | Revenues | |
|--------------------|-------------|-------------|-------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| Medicaid | 11% | 10% | 12% | 12% |
| Medicare | 22% | 20% | 44% | 45% |
| Blue Cross | 11% | 13% | 19% | 20% |
| Commercial | 15% | 16% | 16% | 14% |
| Self pay and other | 41% | 41% | 9% | 9% |
| | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

14. EMPLOYEE HEALTH PLAN

The Hospital is committed to pay for employees' health care costs. A third-party administrator has been retained to process and present all benefit claims to the Hospital for payment. Under a stop loss agreement, the Hospital is responsible for the funding of all claims and related administrative costs up to \$60,000 per individual per policy year with an aggregate maximum of approximately \$1,000,000. Employee health insurance benefit expense was \$1,993,662 and \$1,772,177 for 2009 and 2008, respectively.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

Changes in the balance of claim liabilities during the past two years are as follows:

| | 2009 | 2008 |
|--|--------------------|--------------------|
| Unpaid claims, beginning of year | \$ 300,000 | \$ 400,000 |
| Incurred claims and changes in estimates | 1,993,662 | 1,772,177 |
| Claim payments | <u>(1,993,662)</u> | <u>(1,872,177)</u> |
| Unpaid claims, end of year | <u>\$ 300,000</u> | <u>\$ 300,000</u> |

15. MALPRACTICE COVERAGE

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

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

DUNN MEMORIAL HOSPITAL

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

16. DISCONTINUED OPERATIONS

During 2008, the Hospital discontinued its behavioral health unit. Operating results are included in the loss from operations of the discontinued components in the statement of revenues, expenses and changes in net assets of \$114,552 for 2008. Net patient service revenues for the discontinued components were \$497,508 for 2008.

17. SUBSEQUENT EVENT

Subsequent to December 31, 2009, the Hospital's Board of Governors approved a business combination transaction between the Hospital and a multihospital and healthcare system. The County's governance body also approved the transaction. Pursuant thereto, the Hospital is expected to become part of the multihospital and healthcare system.