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September 20, 2011

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

We have reviewed the audit report prepared by Blue & Co., LLC, Independent Public Accountants, for the period January 1, 2010 to December 31, 2010. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Morgan Hospital and Medical Center, as of December 31, 2010 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



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

CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2010 AND 2009

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

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Morgan Hospital and Medical Center
Martinsville, Indiana

We have audited the accompanying consolidated balance sheets of Morgan Hospital and Medical Center and Affiliated Organizations (the "Medical Center"), component units of Morgan County, as of December 31, 2010 and 2009, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of December 31, 2010 and 2009, and the results of its operations and changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages i through xi be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Blue & Co., LLC

March 21, 2011

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

Management's discussion and analysis of Morgan Hospital and Medical Center and Affiliated Organizations (the "Medical Center") presents information concerning the financial performance during the years ended December 31, 2010 and 2009. This management discussion and analysis includes the activities and results of Morgan Hospital and Medical Center (the "Hospital") and its related entities, which are included in the Consolidated Financial Statements of the Hospital.

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

FINANCIAL HIGHLIGHTS

The Medical Center's net assets increased \$1,889,900 from 2009 to 2010 which includes income from operations of \$1,611,270 and nonoperating revenues of \$278,630. Net assets increased \$2,689,317 from 2008 to 2009 which includes income from operations of \$1,029,103 and non-operating income of \$1,660,214.

- For the year ended December 31, 2010, the Medical Center's total operating revenues increased 4.9% to \$51,753,254 and expenses increased 3.8% to \$50,141,984. Income from operations increased \$582,167 to \$1,611,270. The increase in income from operations can be attributed to higher volumes. Adjusted patient days increased 8.2% from 24,247 to 26,238 and occupancy percentage increased from 17.9% to 20.7%.
- During 2010, gross revenues in pain management increased by \$1,127,106, ICU/CCU by \$1,097,931, medical/surgical by \$1,089,065, laboratory by \$1,077,693, pharmacy by \$867,643 and radiology by \$732,638.
- For the year ended December 31, 2009, the Medical Center's total operating revenues decreased 9.7% to \$49,334,161 and expenses decreased 8.2% to \$48,305,058. Income from operations decreased \$971,327 to \$1,029,103. The decrease in income from operations can be attributed to lower volumes. Adjusted patient days decreased 2.6% from 24,895 to 24,247 and occupancy percentage decreased from 21.8% to 17.9%. In addition, Medicaid Disproportionate Share ("DSH") and Upper Payment Limit ("UPL") payments decreased \$2,308,499 from 2008 to 2009.
- During 2009, the revenues in Laboratory increased by \$1,392,531, Radiology Services by \$1,119,062, Bridges by \$1,088,169, Surgical Services \$736,072, and ICU/CCU by \$660,436.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2010 AND 2009**

FINANCIAL STATEMENTS

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

FINANCIAL ANALYSIS

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

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2010 AND 2009**

A summary of the Medical Center's Consolidated Balance Sheets as of December 31, 2010 and 2009, is presented below:

	<u>2010</u>	<u>2009</u>	<u>\$ Change</u>	<u>% Change</u>
Cash and investments	\$ 25,688,967	\$ 21,253,899	\$ 4,435,068	20.9%
Capital assets	18,950,695	20,692,293	(1,741,598)	-8.4%
Other assets	<u>8,317,033</u>	<u>7,457,041</u>	<u>859,992</u>	11.5%
 Total assets	 <u>\$ 52,956,695</u>	 <u>\$ 49,403,233</u>	 <u>\$ 3,553,462</u>	 7.2%
 Long-term debt, including current portion	 \$ 15,374,489	 \$ 14,507,184	 \$ 867,305	 6.0%
Other current and noncurrent liabilities	<u>7,007,242</u>	<u>6,210,985</u>	<u>796,257</u>	12.8%
 Total liabilities	 22,381,731	 20,718,169	 1,663,562	 8.0%
 Net assets				
Investment in capital assets net of related debt	3,576,206	6,185,109	(2,608,903)	-42.2%
Restricted for donor-designated purposes	27,626	670,626	(643,000)	-95.9%
Unrestricted	<u>26,971,132</u>	<u>21,829,329</u>	<u>5,141,803</u>	23.6%
 Total net assets	 <u>30,574,964</u>	 <u>28,685,064</u>	 <u>1,889,900</u>	 6.6%
 Total liabilities and net assets	 <u>\$ 52,956,695</u>	 <u>\$ 49,403,233</u>	 <u>\$ 3,553,462</u>	 7.2%

As can be seen from the table above, net assets increased in 2010 to \$30,574,964. The change in net assets resulted from income from operations of \$1,611,270 and nonoperating revenues of \$278,630, of which \$822,927 was interest expense, \$1,442,251 was investment income, \$328,789 was the negative change in value of interest rate swaps, \$42,335 was a loss on disposal of capital assets, and the remainder was from contribution income and other expenses.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

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

	2009	2008	\$ Change	% Change
Cash and investments	\$ 21,253,899	\$ 17,727,540	\$ 3,526,359	19.9%
Capital assets	20,692,293	22,579,437	(1,887,144)	-8.4%
Other assets	7,457,041	8,761,198	(1,304,157)	-14.9%
Total assets	\$ 49,403,233	\$ 49,068,175	\$ 335,058	0.7%
Long-term debt, including current portion	\$ 14,507,184	\$ 16,133,372	\$ 7,568,128	46.9%
Other current and noncurrent liabilities	6,210,985	6,939,056	(16,861,443)	-243.0%
Total liabilities	20,718,169	23,072,428	(9,293,315)	-40.3%
Net assets				
Investment in capital assets net of related debt	6,185,109	6,446,065	(12,786,947)	-198.4%
Restricted for donor-designated purposes	670,626	577,626	(25,325,121)	-4384.3%
Unrestricted	21,829,329	18,972,056	21,829,329	115.1%
Total net assets	28,685,064	25,995,747	(16,282,739)	-62.6%
Total liabilities and net assets	\$ 49,403,233	\$ 49,068,175	\$ (25,576,054)	-52.1%

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

**MORGAN HOSPITAL AND MEDICAL CENTER
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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2010 AND 2009

A summary of the Medical Center's Consolidated Statements of Operations for the years ended December 31, 2010 and 2009, is presented below:

	<u>2010</u>	<u>2009</u>	<u>\$ Change</u>	<u>% Change</u>
Operating revenues				
Net patient service revenue	\$ 51,132,677	\$ 48,777,975	\$ 2,354,702	4.8%
Other revenue	<u>620,577</u>	<u>556,186</u>	<u>64,391</u>	11.6%
Total operating revenues	51,753,254	49,334,161	2,419,093	4.9%
Operating expenses				
Salaries and benefits	27,278,871	27,065,767	213,104	0.8%
Supplies and other	20,110,368	18,135,391	1,974,977	10.9%
Depreciation and amortization	<u>2,752,745</u>	<u>3,103,900</u>	<u>(351,155)</u>	-11.3%
Total operating expenses	<u>50,141,984</u>	<u>48,305,058</u>	<u>1,836,926</u>	3.8%
Income from operations	1,611,270	1,029,103	582,167	56.6%
Nonoperating revenues	<u>278,630</u>	<u>1,660,214</u>	<u>(1,381,584)</u>	-83.2%
Change in net assets	<u>\$ 1,889,900</u>	<u>\$ 2,689,317</u>	<u>\$ (799,417)</u>	-29.7%
Net assets, end of year	<u>\$ 30,574,964</u>	<u>\$ 28,685,064</u>	<u>\$ 1,889,900</u>	6.6%

**MORGAN HOSPITAL AND MEDICAL CENTER
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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2010 AND 2009

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

	<u>2009</u>	<u>2008</u>	<u>\$ Change</u>	<u>% Change</u>
Operating revenues				
Net patient service revenue	\$ 48,777,975	\$ 54,216,667	\$ (5,438,692)	-10.0%
Other revenue	<u>556,186</u>	<u>446,879</u>	<u>109,307</u>	24.5%
Total operating revenues	49,334,161	54,663,546	(5,329,385)	-9.7%
Operating expenses				
Salaries and benefits	27,065,767	30,589,862	(3,524,095)	-11.5%
Supplies and other	18,135,391	18,562,744	(427,353)	-2.3%
Depreciation and amortization	<u>3,103,900</u>	<u>3,469,798</u>	<u>(365,898)</u>	-10.5%
Total operating expenses	<u>48,305,058</u>	<u>52,622,404</u>	<u>(4,317,346)</u>	-8.2%
Income from operations	1,029,103	2,041,142	(1,012,039)	-49.6%
Nonoperating revenues	<u>1,660,214</u>	<u>(4,153,558)</u>	<u>5,813,772</u>	140.0%
Change in net assets	<u>\$ 2,689,317</u>	<u>\$ (2,112,416)</u>	<u>\$ 4,801,733</u>	-227.3%
Net assets, end of year	<u>\$ 28,685,064</u>	<u>\$ 25,995,747</u>	<u>\$ 2,689,317</u>	10.3%

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

FINANCIAL ANALYSIS – CASH FLOWS

The Medical Center's 2010 cash flows increased \$3,599,008 due mostly to an improvement in the revenue cycle process including the implementation of the new accounts receivable policy, refinancing of long-term debt, and a positive market swing improving investing activities.

The Medical Center's 2009 cash flows decreased \$1,706,990 due mostly to a decrease in cash received for patient services, noncapital contributions, principal payments on long-term debt, interest expense, and changes in assets whose use is limited.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

SOURCES OF REVENUE

During the year ended December 31, 2010, the Medical Center derived substantially all of its revenues from patient services and other related activities. Revenues include, among other items, revenues from the Medicare and Medicaid programs, insurance carriers, and patients. The table below presents the percentage of gross revenue for patient services, by payor, for the years ended December 31, 2010, 2009, and 2008.

<u>Payor Mix</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Medicare	39.2 %	39.0 %	39.1 %
Medicaid	19.7	20.7	15.3
Blue Cross	17.4	16.8	15.9
Other third-party payors	16.5	16.7	22.9
Self-pay	<u>7.2</u>	<u>6.8</u>	<u>6.8</u>
Total	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

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

OPERATING AND FINANCIAL PERFORMANCE

Overall, the Medical Center's financial performance from operations improved in 2010 compared to 2009, while the Medical Center's overall financial performance declined from 2009 to 2010. This section will discuss highlights of 2010 operations and changes in activity.

Revenues

Net patient service revenues increased 4.8% in 2010 primarily as a result of a rate increase, revenue cycle improvements, and an increase in volumes. Further discussion follows:

- Inpatient activity levels for all units except the nursery, as measured by admissions, increased by 113, or 5.8%. Total patient days (excluding nursery) increased to 8,552, an increase of 6.2%. The increase was attributable to an increase in patient admissions and length of stay in all inpatient units. The increased admissions are partly attributed to improvements in case management, an increase of outpatient surgical procedures by 158 or 8.2%, and higher laboratory and radiology utilization.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

- Outpatient activity levels as measured by visits/registrations decreased 4.8% for the Hospital and 12.8% MPS and MHS.
- The provision for bad debts as a percentage of gross revenue increased from 7.0% in 2009 to 7.7% in 2010. The Medical Center's provision for bad debts continues to remain high compared to other communities due to the economy in the region, higher deductibles and co-pays, and the increased number of uninsured patients.

Expenses

Total operating expenses increased by 3.8% or \$1,836,926 in 2010. Further discussion follows:

- Salaries and benefits increased \$213,104 or 0.8% as a result of reinstatement of merit increases, and an increase in healthcare claims between years.
- Supplies and other expenses increased \$1,974,977 or 10.9% as a result of increased volumes and rising costs.
- Depreciation and amortization expense decreased \$351,155 or 11.3% due to an increasing number of fully depreciated assets.

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

Revenues

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

- Inpatient activity levels for all units except the nursery, as measured by admissions, decreased by 318, or 14.0%. Total patient days (excluding nursery) decreased to 8,054, a decrease of 9.2%. The decrease was attributable to a decrease in patient admissions and length of stay in all inpatient units. The decreased admissions are partly attributed to the loss of physicians and an industry trend toward less inpatient utilization.
- Outpatient activity levels as measured by visits/registrations decreased 6.1% for the Hospital and 0.3% MPS and MHS.
- The provision for bad debts as a percentage of gross revenue increased from 6.3% in 2008 to 7.0% in 2009. The Medical Center's provision for bad debts continues to

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2010 AND 2009

remain high compared to other communities due to the economy in the region, higher deductibles and co-pays, and the increased number of uninsured patients.

Expenses

Total operating expenses decreased by 8.2% or \$4,317,346 in 2009. Further discussion follows:

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

Capital Assets

During 2010, the Medical Center purchased \$1,059,450 of capital assets and retired \$168,949 of capital assets for a net increase of \$890,501 as outlined in the table below:

	<u>2010</u>	<u>2009</u>	<u>\$Change</u>	<u>%Change</u>
Land and land improvements	\$ 2,468,572	\$ 2,468,572	\$ -0-	0.0%
Buildings	22,615,925	22,615,925	-0-	0.0%
Equipment	39,423,994	39,140,297	283,697	0.7%
Construction in progress	<u>662,222</u>	<u>55,418</u>	<u>606,804</u>	1095.0%
	65,170,713	64,280,212	890,501	1.4%
Less accumulated depreciation	<u>(46,220,018)</u>	<u>(43,587,919)</u>	<u>(2,632,099)</u>	6.0%
Capital assets, net	<u>\$ 18,950,695</u>	<u>\$ 20,692,293</u>	<u>\$ (1,741,598)</u>	-8.4%

Gross capital assets increased in 2010 due largely to improvements in the information technology department.

The Medical Center budgeted \$3,000,000 for 2010 capital expenditures but only had purchases of \$1,059,450. The positive variance from actual of \$1,940,550 was primarily due to a concerted effort to only spend capital dollars on essential needs.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2010 AND 2009

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

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

Gross capital assets increased in 2009 due to the purchase of land; remodeling of the physical therapy clinic, the purchase of a new mammography system for the women's life services unit, and a variety of upgrades to the facility itself.

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

Long-Term Debt

During 2010, the 2002A and 2002B Bonds were current refunded with 2010 revenue bonds totaling \$14,000,000. In addition to refinancing the 2002 Bonds, the 2010 Bonds established an approximate \$1,500,000 project fund for future capital projects. At the end of the 2010 fiscal year, the Medical Center had long-term debt (including current portion) of \$15,374,489. Included in this amount is \$13,806,851 of bonds payable that are secured by a pledge of gross revenues.

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

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
DECEMBER 31, 2010 AND 2009

ECONOMIC FACTORS AND 2011 BUDGET

The Medical Center's Board and management considered many factors when establishing the 2011 Budget. Included was the status of the economy, which takes into account market factors and other environmental factors such as the following items:

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

CONTACTING THE MEDICAL CENTER'S CHIEF FINANCIAL OFFICER

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

**MORGAN HOSPITAL AND MEDICAL CENTER
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CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2010 AND 2009

ASSETS	2010	2009
Current assets		
Cash and cash equivalents	\$ 8,048,642	\$ 6,121,977
Certificates of deposit	2,501,026	2,459,337
Patient accounts receivable, net of estimated uncollectibles of \$8,917,646 in 2010 and \$7,219,590 in 2009	6,397,943	5,768,795
Inventories	1,088,845	922,024
Prepaid expenses and other current assets	465,296	459,902
Other assets, current portion	13,636	10,187
Current portion of assets whose use is limited	-0-	11,154,959
Total current assets	18,515,388	26,897,181
Assets whose use is limited, net of amount required to meet current obligations	15,139,299	1,517,626
Capital assets		
Land	1,913,186	1,913,186
Land improvements	555,386	555,386
Buildings	22,615,925	22,615,925
Fixed equipment	5,642,496	5,660,892
Movable equipment	33,781,498	33,479,405
	64,508,491	64,224,794
Less accumulated depreciation	46,220,018	43,587,919
	18,288,473	20,636,875
Construction in progress	662,222	55,418
Capital assets, net	18,950,695	20,692,293
Other assets, net of current portion	351,313	296,133
 Total assets	 \$ 52,956,695	 \$ 49,403,233

See accompanying notes to consolidated financial statements.

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CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2010 AND 2009

LIABILITIES AND NET ASSETS

	2010	2009
Current liabilities		
Accounts payable	\$ 1,878,996	\$ 1,795,663
Accrued payroll and payroll withholdings	818,560	685,245
Accrued expenses	1,591,968	1,162,148
Estimated third-party payor settlements	150,000	450,000
Current portion of obligations under capital leases	819,791	1,191,511
Current portion of long-term debt	524,284	12,046,620
Total current liabilities	5,783,599	17,331,187
 Long-term liabilities		
Obligations under capital leases, net of current portion	768,140	952,590
Long-term debt, net of current portion	13,262,274	316,463
Interest rate swaps	1,599,718	1,270,929
Other	968,000	847,000
Total long-term liabilities	16,598,132	3,386,982
 Total liabilities	 22,381,731	 20,718,169
 Net assets		
Invested in capital assets net of related debt	3,576,206	6,185,109
Restricted		
Expendable for donor-designated purposes	27,626	670,626
Unrestricted	26,971,132	21,829,329
Total net assets	30,574,964	28,685,064
 Total liabilities and net assets	 \$ 52,956,695	 \$ 49,403,233

See accompanying notes to consolidated financial statements.

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

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
Operating revenues		
Net patient service revenue	\$ 51,132,677	\$ 48,777,975
Other revenue	620,577	556,186
Total operating revenues	51,753,254	49,334,161
Operating expenses		
Salaries and wages	21,065,000	21,668,493
Employee benefits and payroll taxes	6,213,871	5,397,274
Professional medical fees	1,921,493	1,325,547
Medical supplies	2,978,893	3,267,163
Other supplies	809,282	755,489
Drugs	3,380,373	2,881,655
Purchased services	7,057,366	5,985,515
Utilities	1,080,773	1,113,936
Insurance	832,940	789,855
Depreciation and amortization	2,752,745	3,103,900
Rent	752,501	724,695
Other operating expenses	1,296,747	1,291,536
Total operating expenses	50,141,984	48,305,058
Income from operations	1,611,270	1,029,103
Nonoperating revenues	278,630	1,660,214
Excess revenues / Change in net assets	1,889,900	2,689,317
Net assets, beginning of year	28,685,064	25,995,747
Net assets, end of year	\$ 30,574,964	\$ 28,685,064

See accompanying notes to consolidated financial statements.

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2010 AND 2009**

	2010	2009
Operating activities		
Cash received for patient services	\$ 50,203,529	\$ 50,364,829
Cash paid to/for employees	(27,145,556)	(27,168,924)
Cash paid to vendors and suppliers	(19,776,204)	(18,159,923)
Other receipts, net	620,577	556,186
Net cash flows from operating activities	3,902,346	5,592,168
Noncapital financing activities		
Noncapital contributions	79,843	160,687
Capital and related financing activities		
Principal payments on obligations under capital leases	(1,215,780)	(1,763,207)
Principal payments on long-term debt	(12,341,827)	(710,377)
Interest paid	(848,742)	(1,100,497)
Purchases of capital assets	(393,066)	(855,994)
Proceeds from sale of capital assets	14,519	-0-
Change in bond refunding loss	(336,738)	-0-
Change in bond discount	102,040	6,896
Borrowings on long-term debt	14,000,000	500,500
Loss on disposal of capital assets	42,335	3,033
Net cash flows from capital and related financing activities	(977,259)	(3,919,646)
Investing activities		
Investment income	1,442,251	2,695,316
Change in certificates of deposit	(41,689)	(73,882)
Change in assets whose use is limited	(794,371)	(5,159,467)
Other nonoperating revenues (expenses)	(394,722)	(115,793)
Change in interest rate swaps	328,789	(1,029,028)
Change in other long-term liabilities	121,000	121,000
Change in other assets	(67,180)	21,655
Net cash flows from investing activities	594,078	(3,540,199)
Net change in cash and cash equivalents	3,599,008	(1,706,990)
Cash and cash equivalents, beginning of year	8,020,149	9,727,139
Cash and cash equivalents, end of year	\$ 11,619,157	\$ 8,020,149
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents in current assets	\$ 8,048,642	\$ 6,121,977
Cash and cash equivalents in assets whose use is limited	3,570,515	1,898,172
Total cash and cash equivalents	\$ 11,619,157	\$ 8,020,149

See accompanying notes to consolidated financial statements.

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2010 AND 2009**

	2010	2009
Reconciliation of income from operations to net cash and cash equivalents from operating activities		
Income from operations	\$ 1,611,270	\$ 1,029,103
Adjustments to reconcile income from operations to net cash flows from operating activities		
Depreciation	2,744,194	3,080,105
Amortization	8,551	23,795
Provision for bad debts	12,769,415	10,507,174
Changes in operating assets and liabilities		
Patient accounts receivable	(13,398,563)	(9,345,320)
Inventories	(166,821)	127,327
Prepaid expenses and other current assets	(5,394)	(30,474)
Accounts payable	76,559	151,990
Accrued payroll and payroll withholdings	133,315	(103,157)
Accrued expenses	429,820	(273,375)
Estimated third party payor settlements	(300,000)	425,000
Net cash flows from operating activities	\$ 3,902,346	\$ 5,592,168
 Supplemental disclosures of noncash capital and related financing activities		
Capital assets acquired included in accounts payable	\$ 6,774	\$ -0-
Capital assets acquired under capital leases	\$ 659,610	\$ 340,000

See accompanying notes to consolidated financial statements.

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

1. NATURE OF OPERATIONS

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Reporting Entity and Consolidation Policy

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

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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

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

Management's Estimates

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

Proprietary Fund Accounting

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

Accounting Standards

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

Risk Management

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

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Cash and Cash Equivalents

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

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

Patient Accounts Receivable and Net Patient Service Revenue

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

Allowance for Patient Uncollectible Accounts

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

Inventories

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

Assets Whose Use is Limited

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

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

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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

Capital Assets

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

Costs of Borrowing

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

Other Assets

Other assets consist of notes receivable and bond issues costs. Bond issue costs are being amortized over the lives of the bonds on the straight-line method.

Net Assets

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

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

Consolidated Statements of Operations and Changes in Net Assets

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

Performance Indicator

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

Charity Care

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

Advertising and Public Relations Costs

Advertising and public relations costs are charged to operations when incurred. Advertising and public relations costs charged to operations were \$449,237 and \$501,410 for the years ended December 31, 2010 and 2009, respectively.

Income Taxes

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

Grants and Contributions

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

MORGAN HOSPITAL AND MEDICAL CENTER AND AFFILIATED ORGANIZATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported within nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues.

Change in Accounting Principle

In 2010, the Medical Center adopted GASB No. 53, *Accounting and Financial Reporting for Derivative Instruments*. The Medical Center is a party to two interest rate swap agreements which are derivative instruments. The new guidance requires governmental entities to evaluate each derivative instrument to determine whether the instrument is an effective hedge. For those instruments deemed to be an effective hedge, governmental entities are required to practice hedge accounting and the instrument continues to be reevaluated at the end of each future reporting period. Under hedge accounting, the fair value of the instrument is recorded on the balance sheet with the offsetting entry to deferred outflows or deferred inflows, which are also reported on the balance sheet.

For those instruments deemed to be an ineffective hedge, governmental entities are required to practice investment accounting and the instruments are not evaluated in future reporting periods. Once deemed ineffective, the instrument is considered ineffective for the remainder of its term. Under investment accounting, the fair value of the instrument is recorded on the balance sheet with the offsetting entry posted to investment income. In accordance with the new guidance, the Medical Center evaluated its two interest rate swap agreements and determined them to be ineffective hedges. As the interest rate swap agreements were previously recorded in a similar manner to investment accounting, the Medical Center's adoption of a new accounting principle did not have a significant impact on the accompanying consolidated financial statements.

Reclassifications

Certain 2009 amounts have been reclassified to provide for consistency with reporting of 2010 information. These reclassifications have no effect on the previously reported change in net assets or net assets.

Subsequent Events

The Medical Center has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is March 21, 2011.

**MORGAN HOSPITAL AND MEDICAL CENTER
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

3. BANK DEPOSITS AND INVESTMENTS

Deposits and investments are comprised of the following at December 31, 2010 and 2009:

	2010	2009
Carrying amount		
Cash and cash equivalents	\$ 11,619,157	\$ 8,020,149
Certificates of deposit	2,686,163	2,642,826
Mutual funds	10,415,647	9,100,924
Cash surrender value of life insurance	968,000	847,000
 Total	 \$ 25,688,967	 \$ 20,610,899
Included in the consolidated balance sheet captions:		
Cash and cash equivalents	\$ 8,048,642	\$ 6,121,977
Certificates of deposit	2,501,026	2,459,337
Assets whose use is limited	15,139,299	12,029,585
 Total	 \$ 25,688,967	 \$ 20,610,899

Custodial Credit Risk – Deposits

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

Investments are carried at fair market value or cost which approximates fair value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. As of December 31, 2010 and 2009, the Medical Center had the following investments and maturities, all of which were held in the Medical Center's name by custodial banks or investment companies that are agents of the Medical Center:

**MORGAN HOSPITAL AND MEDICAL CENTER
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009**

	December 31, 2010				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1 - 5	6 - 10	More than 10
Certificates of deposit	<u>\$ 2,686,163</u>	<u>\$ 2,686,163</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

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

Interest Rate Risk

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

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

Credit Risk – Investments

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

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

Concentration of Credit Risk

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

**MORGAN HOSPITAL AND MEDICAL CENTER
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable reported as current assets at December 31, 2010 and 2009, consist of the following:

	2010	2009
Receivable from Medicare	\$ 9,514,388	\$ 5,686,179
Receivable from Medicaid	3,627,760	3,012,485
Receivable from Blue Cross	2,787,941	2,095,093
Receivable from other insurance carriers	5,279,889	3,591,476
Receivable from patients	8,221,286	7,855,502
Total patient accounts receivable	29,431,264	22,240,735
Less allowance for contractals	14,115,675	9,252,350
Less allowance for uncollectible amounts	8,917,646	7,219,590
 Patient accounts receivable, net	 \$ 6,397,943	 \$ 5,768,795

5. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited that are required for obligations classified as current liabilities or are receivable within one year are reported in current assets, if any. Assets whose use is limited are reported at market value or cost which approximates fair value and include the following at December 31, 2010 and 2009:

Total Investment Summary by Class

	2010	%	2009	%
Cash and cash equivalents	\$ 3,570,515	23.6 %	\$ 1,898,172	15.0 %
Cash surrender value of life insurance	968,000	6.4	847,000	6.7
Certificates of deposit	185,137	1.2	183,489	1.4
Mutual funds	10,415,647	68.8	9,100,924	71.8
Donation receivable	-0-	0.0	643,000	5.1
 Total assets whose use is limited	 15,139,299	 100.0 %	 12,672,585	 100.0 %
 Less amount required for current obligations	 -0-		 11,154,959	
 Assets whose use is limited, net of amount required to meet current obligations	 \$ 15,139,299		 \$ 1,517,626	

**MORGAN HOSPITAL AND MEDICAL CENTER
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009**

Total Investment Summary by Fund

	2010	%	2009	%
Board-Designated Funds	\$ 10,866,785	71.8 %	\$ 9,556,365	75.4 %
Building Fund	1,614,973	10.6	1,598,594	12.6
Trustee Held Funds	1,661,915	11.0	-0-	0.0
Donor-Restricted Funds	27,626	0.2	670,626	5.3
Insurance Benefit Plan	968,000	6.4	847,000	6.7
Total	\$ 15,139,299	100.0 %	\$ 12,672,585	100.0 %

Board-Designated Funds

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

Building Fund

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

Trustee-Held Funds

Trustee-held funds represent a Project Fund held in connection with the issue of the Series 2010 bonds. Funds may be used by the Medical Center for the purchase of capital assets in accordance with the bond agreement.

Insurance Benefit Plan Assets

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

Donor-Restricted Funds

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

**MORGAN HOSPITAL AND MEDICAL CENTER
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009**

Fair Value Measurements and Disclosures

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

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

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets whose use is limited				
Cash surrender value of life insurance	\$ -0-	\$ -0-	\$ 968,000	\$ 968,000
Mutual funds	<u>10,415,647</u>	<u>-0-</u>	<u>-0-</u>	<u>10,415,647</u>
	<u>\$ 10,415,647</u>	<u>\$ -0-</u>	<u>\$ 968,000</u>	<u>\$ 11,383,647</u>
Long-term liabilities				
Interest rate swaps	<u>\$ -0-</u>	<u>\$ 1,599,718</u>	<u>\$ -0-</u>	<u>\$ 1,599,718</u>

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

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

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The following table sets forth a summary of changes in the fair values of the Medical Center's Level 3 assets for the year ended December 31, 2010:

	<u>Cash Surrender Value of Life Insurance</u>
Balance, beginning of year	\$ 847,000
Change in cash surrender value of life insurance	<u>121,000</u>
Balance, end of year	<u>\$ 968,000</u>

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

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

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

**MORGAN HOSPITAL AND MEDICAL CENTER
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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6. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2010 and 2009, was as follows:

	2010			
	Beginning Balance	Additions	Retirements / Transfers	Ending Balance
Land	\$ 1,913,186	\$ -0-	\$ -0-	\$ 1,913,186
Land improvements	555,386	-0-	-0-	555,386
Buildings	22,615,925	-0-	-0-	22,615,925
Fixed equipment	5,660,892	-0-	(18,396)	5,642,496
Movable equipment	33,479,405	399,840	(97,747)	33,781,498
Construction in progress	55,418	659,610	(52,806)	662,222
Total historical cost	<u>64,280,212</u>	<u>1,059,450</u>	<u>(168,949)</u>	<u>65,170,713</u>
Less accumulated depreciation for				
Land improvements	(395,079)	(22,680)	-0-	(417,759)
Buildings	(12,626,916)	(467,445)	-0-	(13,094,361)
Fixed equipment	(4,521,846)	(146,566)	17,476	(4,650,936)
Movable equipment	(26,044,078)	(2,107,503)	94,619	(28,056,962)
Total accumulated depreciation	<u>(43,587,919)</u>	<u>(2,744,194)</u>	<u>112,095</u>	<u>(46,220,018)</u>
Capital assets, net	<u>\$ 20,692,293</u>	<u>\$ (1,684,744)</u>	<u>\$ (56,854)</u>	<u>\$ 18,950,695</u>
	2009			
	Beginning Balance	Additions	Retirements / Transfers	Ending Balance
Land	\$ 1,697,186	\$ 216,000	\$ -0-	\$ 1,913,186
Land improvements	555,386	-0-	-0-	555,386
Buildings	22,549,914	66,011	-0-	22,615,925
Fixed equipment	5,662,332	-0-	(1,440)	5,660,892
Movable equipment	32,624,428	861,882	(6,905)	33,479,405
Construction in progress	108,973	52,101	(105,656)	55,418
Total historical cost	<u>63,198,219</u>	<u>1,195,994</u>	<u>(114,001)</u>	<u>64,280,212</u>
Less accumulated depreciation for				
Land improvements	(369,429)	(25,650)	-0-	(395,079)
Buildings	(12,152,895)	(474,021)	-0-	(12,626,916)
Fixed equipment	(4,365,522)	(157,764)	1,440	(4,521,846)
Movable equipment	(23,730,936)	(2,422,670)	109,528	(26,044,078)
Total accumulated depreciation	<u>(40,618,782)</u>	<u>(3,080,105)</u>	<u>110,968</u>	<u>(43,587,919)</u>
Capital assets, net	<u>\$ 22,579,437</u>	<u>\$ (1,884,111)</u>	<u>\$ (3,033)</u>	<u>\$ 20,692,293</u>

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7. COMPENSATED ABSENCES

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

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

<u>Length of Service</u>	<u>Hospital Hours Earned Per Year</u>	<u>MHS Hours Earned Per Year (Date of Hire Pre-2004)</u>	<u>MHS Hours Earned Per Year (Date of Hire 2004 and After)</u>
0 - 5 years	195	195	150
6 - 14 years	232.5	232.5	150
15 or more years	270	270	150

PTO days are accrued when incurred and reported as accrued expenses in the consolidated financial statements. The PTO accrual at December 31, 2010 and 2009, was \$710,850 and \$692,421, respectively.

8. EMPLOYEE HEALTH BENEFIT PLAN

The Medical Center operates a self-funded health plan covering substantially all eligible employees. The Medical Center has an annual stop loss limit on the plan of \$135,000 per individual. The Medical Center does not carry aggregate stop loss limits. Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of pay out, and other economic and social factors.

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Changes in the balances of claims liabilities during the years ended December 31, 2010 and 2009, were as follows:

	<u>2010</u>	<u>2009</u>
Accrued liability, beginning of year	\$ 339,153	\$ 494,298
Incurred claims and changes in estimates	3,702,201	2,655,070
Claim payments	<u>3,461,138</u>	<u>2,810,215</u>
Accrued liability, end of year	<u>\$ 580,216</u>	<u>\$ 339,153</u>

The accrued liability for the health benefit plan is included in Accrued Expenses on the Consolidated Balance Sheets.

9. PENSION PLAN

The Medical Center sponsors separate defined contribution pension plans that cover all eligible employees who work over 1,000 hours a year. To be eligible for enrollment, employees must have completed one year of employment and be 21 years of age. The Hospital and MHS contribute for each eligible participant an amount equal to 2 percent of compensation that does not exceed 150 percent of the social security contribution. In addition, the Hospital and MHS match up to an additional 2 percent of each participant's contribution to the plan at a matching rate of 50 percent. MPS sponsors various defined contribution pension plans that cover all eligible employees (physicians) according to the terms of each physician's individual employment agreement. The Medical Center incurred expenses related to these plans of \$783,209 and \$775,798 for the years ended December 31, 2010 and 2009, respectively.

10. OBLIGATIONS UNDER CAPITAL LEASES

The Medical Center is the lessee of equipment under capital leases expiring in various years through 2014. The assets and liabilities under the capital lease are originally recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. Amortization of assets held under the capital lease is included in depreciation expenses and was \$460,441 and \$1,100,179 for the years ended December 31, 2010 and 2009, respectively. The capital lease obligations carry imputed interest rates between 3.3 and 8.4 percent, and are collateralized by the leased equipment.

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Following is a summary of equipment held under capital leases:

	2010	2009
Equipment	\$ 3,506,826	\$ 7,222,143
Less: accumulated amortization	1,383,129	4,330,344
	\$ 2,123,697	\$ 2,891,799

Capital lease activity for the years ended December 31, 2010 and 2009, was as follows:

	2010				
	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Obligations under capital leases	<u>\$ 2,144,101</u>	<u>\$ 659,610</u>	<u>\$ 1,215,780</u>	<u>\$ 1,587,931</u>	<u>\$ 819,791</u>

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

Debt service requirements on obligations under capital leases at December 31, 2010, are as follows:

Year Ending December 31,	Principal	Interest
2011	\$ 819,791	\$ 52,340
2012	406,349	22,498
2013	288,376	7,093
2014	73,415	1,220
Total	<u>\$ 1,587,931</u>	<u>\$ 83,151</u>

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11. LONG-TERM DEBT

At December 31, 2010 and 2009, the Medical Center was obligated for long-term debt agreements as follows:

	2010	2009
Economic Development Revenue Bonds, Series 2002A, dated December 17, 2002, payable in annual principal installments commencing December 1, 2003 through December 1, 2027, in amounts ranging from \$45,000 to \$95,000. Variable interest rate determined weekly (0.75% at December 31, 2009). Interest is paid in monthly installments. Secured by letter of credit from Fifth Third Bank.	\$ -0-	\$ 1,350,000
Economic Development Revenue Bonds, Series 2002B, dated December 17, 2002, payable in annual principal installments commencing December 1, 2004 through December 1, 2027, in amounts ranging from \$255,000 to \$780,000. Variable interest rate determined weekly (0.75% at December 31, 2009); Interest is paid in monthly installments. Secured by letter of credit from Fifth Third Bank.	-0-	10,695,000
Note payable to bank dated January 2009; monthly principal and interest payments of \$8,633 commencing March 2009 and ending February 2012. Fixed interest rate of 5.5% per annum. Secured by deposit amounts and certificates of deposit.	116,662	211,019
Note payable to bank dated April 2009; monthly principal and interest payments of \$1,843 commencing May 2009 through April 2024. Fixed interest rate of 6.25% per annum. Secured by mortgage on Hospital property.	199,783	209,104

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Economic Development Revenue Bonds, Series 2010, dated June 17, 2010, payable in annual principal installments commencing December 1, 2010 through December 1, 2029, in amounts ranging from \$193,149 to \$1,119,530. Variable interest rate determined monthly (2.19% at December 31, 2010); Interest is paid in monthly installments. Secured by Hospital revenues.	<u>13,806,851</u>	<u>-0-</u>
Total long-term debt	14,123,296	12,465,123
Bond refunding loss	(336,738)	-0-
Less unamortized bond discounts	-0-	(102,040)
Less current portion	<u>(524,284)</u>	<u>(12,046,620)</u>
Long-term debt, net of current portion	<u>\$ 13,262,274</u>	<u>\$ 316,463</u>

On December 17, 2002, Morgan County, Indiana issued \$14,030,000 of Adjustable Rate Demand Economic Development Revenue Bonds, Series 2002A and 2002B (the "2002 Bonds") on behalf of the Medical Center. The proceeds of the 2002 Bonds were used to finance the acquisition, construction, and equipping of certain economic development facilities, including a new oncology center, a new medical office building and other capital improvements to the Medical Center; advance refund the Morgan County Hospital Association First Mortgage Revenue Refunding Bonds, Series 1993 and other loans and capital leases of the Medical Center; pay capitalized interest on the 2002 Bonds; and pay certain costs related to the issuance of the 2002 Bonds.

On June 17, 2010, Morgan County, Indiana issued \$14,000,000 of Adjustable Rate Demand Economic Development Revenue Bonds, Series 2010 (the "2010 Bonds") on behalf of the Medical Center. The proceeds of the 2010 Bonds were used to refund the 2002 Bonds, to establish an approximate \$1,500,000 project fund for future projects, and to pay for the bond issuance costs relating to the 2010 Bonds.

Interest Rate Swap Agreements

Contracts

The Medical Center has two interest rate swap agreements (the "Swaps") with a highly rated counterparty in effect at December 31, 2010. The Swaps were originally entered into as a means of fixing the interest costs associated with the 2002 Bonds. Effective in June 2010, the Swaps are utilized as a means of fixing a portion of the interest costs on the 2010 Bonds.

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Objectives

As a means to lower its borrowing costs and increase its savings, when compared against fixed-rate refunding bonds at the time of issuance, the Medical Center entered into interest rate swaps in connection with its 2002 Bonds. The intention of the Swap agreement was to effectively change the Medical Center's variable interest rate on the bonds to a synthetic fixed rate of 3.82% and 3.99% for interest rate management purposes. Beginning in June 2010, the Medical Center began utilizing the Swaps for the same purpose on the 2010 Bonds. The Medical Center is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreements. However, the Medical Center does not anticipate nonperformance by the counterparties.

Terms, Fair Values, and Credit Risk

The terms, fair values, and credit ratings of the outstanding Swaps as of December 31, 2010 are as follows:

Swaps	Notional Amount	Effective Date	Fixed Rate Paid	Variable Rate Received (1)	Fair Values	Termination Date	Counterparty Credit Rating (2)
Swap "B"	\$ 5,000,000	5/5/2005	3.82%	Bond Market Association Municipal Swap Index	\$ (487,563)	5/1/2015	A
Swap "C"	<u>6,685,000</u>	7/16/2007	3.99%	67% of LIBOR	<u>(1,112,155)</u>	12/1/2027	A
	<u>\$ 11,685,000</u>				<u>\$ (1,599,718)</u>		

(1) LIBOR - London Interbank Offered Rate

(2) Counter party's guarantor

The notional amounts of the Swaps are inconsistent with the principal amount of the associated debt and do not decline with the principal amortization of the bonds. Therefore, the Swaps do not qualify as hedging derivatives. The Swaps are marked-to-market on the consolidated balance sheet at fair value at the end of each fiscal year. The change in fair market value of the Swaps is included as a component of investment income in nonoperating revenues. The fair value of the Swaps is reported as a long term liability of \$1,599,718 and \$1,270,929 in the consolidated balance sheets at December 31, 2010 and 2009, respectively. See also Note 14 and Note 20 for items related to the Swaps.

As of December 31, 2010 the negative fair values of the agreements may be countered by reductions in the total interest payments required under the variable-rate bonds, creating lower synthetic rates. The counterparty carries a guarantee

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by an entity (“counterparty guarantor”) rated A2 by Moody’s Investors Service (“Moody’s”), A by Standard and Poor’s (“S&P”), and A by Fitch Ratings (“Fitch”).

Basis Risk

The Medical Center is exposed to basis risk on its Swaps because the variable-rate payments received by the Medical Center are based on a rate or index other than the interest rates the Medical Center pays on the 2010 Bonds. As of December 31, 2010, the interest rate on the Medical Center’s variable-rate debt is 2.19 percent while the Bond Market Association Municipal Swap Index is 0.30 percent and 67 percent of LIBOR is 0.18 percent.

Termination Risk

The counterparty may terminate the Swaps, in whole but not in part, by providing at least five business days’ prior written notice to the Medical Center of its election to terminate this transaction and evidence reasonably satisfactory to the Medical Center that any and all amounts owed to the counterparty in connection with such early termination shall be paid on the due date thereof (the effective date of such optional early termination). In the event of such termination, the Calculation Agent shall determine the amount owed in connection with the termination using its commercially reasonable judgment.

Additional information regarding fair value measurements of the interest rate swap agreements is disclosed in Note 5.

Long-term debt activity for the years ended December 31, 2010 and 2009, was as follows:

	2010				Current Portion
	Beginning Balance	Increases	Decreases	Ending Balance	
Revenue bonds, series 2002A	\$ 1,350,000	\$ -0-	\$ (1,350,000)	\$ -0-	\$ -0-
Revenue bonds, series 2002B	10,695,000	-0-	(10,695,000)	-0-	-0-
Note payable to bank	211,019	-0-	(94,357)	116,662	99,666
Note payable to bank	209,104	-0-	(9,321)	199,783	10,011
Revenue bonds, series 2010	-0-	14,000,000	(193,149)	13,806,851	434,415
Bond discounts	(102,040)	-0-	102,040	-0-	-0-
Bond refunding losses	-0-	(346,642)	9,904	(336,738)	(19,808)
Total long-term debt	\$ 12,363,083	\$ 13,653,358	\$ (12,229,883)	\$ 13,786,558	\$ 524,284

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

Debt Service Requirements

Using interest rates in effect for all variable-rate debt as of December 31, 2010, total debt service requirements are as follows. All variable-rate debt and net swap payments assume current interest rates will remain the same for the term of the bonds. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Year Ending December 31,	Principal	Interest	Interest Rate Swaps, Net	Total
2011	\$ 524,284	\$ 317,909	\$ 429,039	\$ 1,271,232
2012	465,615	303,967	408,774	1,178,356
2013	474,024	293,163	387,937	1,155,124
2014	500,806	281,892	366,512	1,149,210
2015	529,043	270,006	243,071	1,042,120
2016-2020	3,125,416	1,147,696	1,437,724	5,710,836
2021-2025	4,061,407	738,238	756,566	5,556,211
2026-2029	4,105,963	232,477	93,520	4,431,960
Total	\$ 13,786,558	\$ 3,585,348	\$ 4,123,143	\$ 21,495,049

Agreements relating to these long-term debt agreements contain various restrictive covenants, including covenants related to debt service coverage ratio, cash to debt ratio, and the submission of audited financial statements. The Medical Center was in violation of certain restrictive covenants in 2009, and did not obtain a covenant violation waiver letter from Fifth Third Bank concerning the letter of credit. Therefore, long term debt amounts secured by the bank letter of credit have been reported as current liabilities within the consolidated balance sheets for the year ended December 31, 2009.

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12. INSURANCE BENEFIT PLAN

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

13. NET PATIENT SERVICE REVENUE

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

- **Medicare**. The Medical Center is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Medical Center is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping ("DRG") and Medicare outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Medical Center's year end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from, or payable to the third-party program. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admissions are subject to an independent review by a peer review organization under contract with the Medical Center. As of December 31, 2010, the Medical Center's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2006.
- **Medicaid**. The Medical Center is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Medical Center is reimbursed for Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping ("DRG") and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. There is no cost settlement for either of the inpatient or outpatient. For the years ended December 31, 2010 and 2009, the Medical Center received and recorded in net patient service revenue \$1,711,970 and \$1,764,112, respectively, relating to net Medicaid Disproportionate Share

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Hospital (“DSH”) payments and/or Indiana Medicaid Municipal Hospital Upper Payment Limit (“UPL”) adjustments.

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. Compliance with such laws and regulations can be subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs. The Medical Center believes that it is in compliance with all applicable laws and regulations.

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

For the years ended December 31, 2010 and 2009, net patient service revenue was as follows:

	2010	2009
Gross patient service revenue		
Inpatient routine services	\$ 13,562,884	\$ 11,863,122
Inpatient ancillary services	28,134,100	24,238,959
Outpatient ancillary services	124,222,998	114,381,834
Total gross patient service revenue	165,919,982	150,483,915
Deductions from revenue		
Contractual allowances	100,721,491	90,269,899
Charity care	1,296,399	928,867
Bad debts	12,769,415	10,507,174
Total deductions from revenue	114,787,305	101,705,940
Total net patient service revenue	\$ 51,132,677	\$ 48,777,975

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

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14. NONOPERATING REVENUES

For the years ended December 31, 2010 and 2009, nonoperating revenues were as follows:

	2010	2009
Investment income	\$ 1,442,251	\$ 1,666,288
Investment income (loss) - fair value change of interest rate swaps	(328,789)	1,029,028
Interest expense	(822,927)	(1,079,996)
Loss on disposal of capital assets	(42,335)	(3,033)
Contribution income	79,843	160,687
Other	(49,413)	(112,760)
Total nonoperating revenues	\$ 278,630	\$ 1,660,214

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

15. PROFESSIONAL LIABILITY INSURANCE

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

The Medical Center is insured against professional liability claims on a claims-made basis. Liabilities for incurred but not reported losses at December 31, 2010 and 2009, are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Medical Center's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the claims-made policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Medical Center intends to continue carrying such insurance. Professional liability insurance coverage for the Hospital is \$250,000 per occurrence and \$7,500,000 in the aggregate. Professional liability insurance coverage for MHS and MPS is \$250,000 per occurrence and \$750,000 in

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the aggregate. In addition, the Medical Center has umbrella coverage of \$5,000,000 per occurrence and in the aggregate. Professional liability insurance expense for the years ended December 31, 2010 and 2009, was \$641,932 and \$631,292, respectively.

16. CONCENTRATIONS OF CREDIT RISK

The Medical Center grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements. The mix of gross revenue and receivables from patients and third-party payors at December 31, 2010 and 2009, was as follows:

	2010		2009	
	Revenues	Receivables	Revenues	Receivables
Medicare	39 %	32 %	39 %	26 %
Medicaid	20	12	21	14
Blue Cross	17	9	17	9
Other third-party payors	17	18	17	16
Patients	7	29	6	35
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

17. CONTINGENCIES

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

18. COMMITMENTS

As of December 31, 2010, the Hospital has construction in progress commitments as follows, which include equipment acquired under a capital lease agreement that was received in 2010 but not placed into service until 2011:

Project	Expected Date of Completion	Estimated Total Cost of Project	Costs Incurred as of December 31, 2010
Server/Infrastructure Upgrade	February 2011	\$ 659,610	\$ 659,610
All others	Various	2,612	2,612
		<u>\$ 662,222</u>	<u>\$ 662,222</u>

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19. TRANSFERS

For the years ended December 31, 2010 and 2009, MHS received transfers from the Hospital totaling \$1,707,713 and \$1,742,863, respectively. MPS received transfers from the Hospital in the amount of \$1,361,018 and \$1,217,733, for the years ended December 31, 2010 and 2009, respectively. These transfers have been eliminated in consolidation.

20. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Cash and Cash Equivalents

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates its fair value based on short maturities of those items.

Certificates of Deposit and Assets Whose Use is Limited

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

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

The carrying amounts reported in the consolidated balance sheets for accounts payable, accrued payroll and payroll withholdings, and accrued expenses approximate their fair value based upon short maturities of those items.

Estimated Third-Party Payor Settlements

The carrying amount reported in the consolidated balance sheets for estimated third-party payor settlements approximates its fair value because they are expected to be settled in the near future.

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

The carrying amount and fair value reported in the consolidated balance sheets for the combined amounts of long-term debt and obligations under capital leases were \$15,374,489 and \$15,404,621, respectively, for 2010 and \$14,507,184 and

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\$14,537,377, respectively, for 2009. The carrying amount reported in the consolidated financial balance sheets for debt approximates fair value based upon the variable nature of the primary debt. The carrying amount reported in the consolidated balance sheets for deferred compensation liabilities approximates its fair value.

Interest Rate Swaps

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

21. SUBSEQUENT EVENT - AFFILIATION AGREEMENT

As of the report date of the consolidated financial statements, the Medical Center has entered into an agreement with Clarian Health Partners, an Indiana nonprofit corporation, a/k/a Indiana University Health ("IU Health"). The agreement allows for the Medical Center to become an affiliate of IU Health by transferring substantially all assets and liabilities into a new Indiana nonprofit corporation named Indiana University Health Morgan Hospital, Inc. ("IUH Morgan"). The Board of Commissioners of Morgan County, Indiana ("Commissioners"), would effectively cede Morgan County government's control and ownership of the Medical Center's assets and liabilities for no payment. IUH Morgan would be operated and controlled by IU Health. The Medical Center would be legally dissolved.