

DeKalb Memorial Hospital, Inc.

Accountants' Report and Financial Statements

September 30, 2010 and 2009



DeKalb Memorial Hospital, Inc.
September 30, 2010 and 2009

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Independent Accountants' Report

Finance and Audit Committee
DeKalb Memorial Hospital, Inc.
Auburn, Indiana

We have audited the accompanying balance sheets of DeKalb Memorial Hospital, Inc. (Hospital) as of September 30, 2010 and 2009, and the related statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of DeKalb Memorial Hospital, Inc. as of September 30, 2010 and 2009, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

November 19, 2010

DeKalb Memorial Hospital, Inc.

Balance Sheets September 30, 2010 and 2009

	2010	2009
Assets		
Current Assets		
Cash and cash equivalents	\$ 6,285,304	\$ 4,238,937
Accounts receivable		
Patient services, net of allowance for uncollectible accounts; 2010 - \$1,205,214; 2009 - \$3,279,793	7,552,453	8,197,446
Other	302,444	569,000
Estimated amounts due from third-party payers	214,519	—
Inventory	522,359	485,150
Prepaid expenses	363,595	461,550
Total current assets	15,240,674	13,952,083
Assets Limited as to Use		
Internally designated	13,242,538	11,873,081
Externally restricted by donor	84,218	685,860
Held by trustee	1,181,756	1,299,756
Total assets limited as to use	14,508,512	13,858,697
Property and Equipment, Net	30,290,559	31,463,092
Other Assets	135,165	140,321
Total assets	\$ 60,174,910	\$ 59,414,193
Liabilities and Net Assets		
Current Liabilities		
Current maturities of long-term debt	\$ 1,149,456	\$ 1,096,017
Accounts payable	1,546,435	1,548,936
Accrued salaries, wages and related liabilities	2,230,299	2,811,282
Other accrued liabilities	688,496	665,786
Total current liabilities	5,614,686	6,122,021
Long-Term Debt, less current maturities	6,568,489	7,707,432
Total liabilities	12,183,175	13,829,453
Net Assets		
Unrestricted	47,907,517	44,898,880
Temporarily restricted	84,218	685,860
Total net assets	47,991,735	45,584,740
Total liabilities and net assets	\$ 60,174,910	\$ 59,414,193

DeKalb Memorial Hospital, Inc.
Statements of Operations
Years Ended September 30, 2010 and 2009

	2010	2009
Unrestricted Revenue, Gains and Other Support		
Net patient service revenue	\$ 43,080,908	\$ 41,559,790
Other	1,726,484	1,720,900
Net assets released from restrictions used for operations	<u>29,069</u>	<u>33,315</u>
Total unrestricted revenue, gains and other support	<u>44,836,461</u>	<u>43,314,005</u>
Expenses		
Salaries and wages	17,525,387	17,604,002
Payroll taxes and employee benefits	6,073,138	5,359,551
Purchased medical services	3,263,623	3,095,124
Medical supplies and drugs	4,068,153	3,775,532
Insurance	572,015	533,838
Depreciation and amortization	3,523,183	3,391,464
Interest	390,463	430,065
Provision for uncollectible accounts	3,267,512	3,833,842
Other	<u>5,224,979</u>	<u>5,249,908</u>
Total expenses	<u>43,908,453</u>	<u>43,273,326</u>
Operating Income	<u>928,008</u>	<u>40,679</u>
Other Income (Expense)		
Contributions received	12,734	38,085
Investment return, dividends, interest and realized gains (losses)	1,132,576	(980,911)
Investment return, change in unrealized gains or losses on trading securities	372,412	(1,077,052)
Loss on investment in equity investee	<u>(42,921)</u>	<u>(117,503)</u>
Total other income (expense)	<u>1,474,801</u>	<u>(2,137,381)</u>
Excess (Deficiency) of Revenue Over Expenses	2,402,809	(2,096,702)
Investment return, change in unrealized gains and losses on other than trading securities	—	2,488,733
Net assets released from restrictions used for purchase of property and equipment	<u>605,826</u>	<u>44,007</u>
Increase in Unrestricted Net Assets	<u>\$ 3,008,635</u>	<u>\$ 436,038</u>

DeKalb Memorial Hospital, Inc.
Statements of Changes in Net Assets
Years Ended September 30, 2010 and 2009

	2010	2009
Unrestricted Net Assets		
Excess (deficiency) of revenue over expenses	\$ 2,402,809	\$ (2,096,702)
Investment return, change in unrealized gains and losses on other than trading securities	—	2,488,733
Net assets released from restrictions used for purchase of property and equipment	<u>605,826</u>	<u>44,007</u>
Increase in unrestricted net assets	<u>3,008,635</u>	<u>436,038</u>
Temporarily Restricted Net Assets		
Contributions received	33,255	673,687
Net assets released from restrictions	<u>(634,895)</u>	<u>(77,322)</u>
Increase (decrease) in temporarily restricted net assets	<u>(601,640)</u>	<u>596,365</u>
Increase in Net Assets	2,406,995	1,032,403
Net Assets, Beginning of Year	<u>45,584,740</u>	<u>44,552,337</u>
Net Assets, End of Year	<u>\$ 47,991,735</u>	<u>\$ 45,584,740</u>

DeKalb Memorial Hospital, Inc.
Statements of Cash Flows
Years Ended September 30, 2010 and 2009

	2010	2009
Operating Activities		
Change in net assets	\$ 2,406,995	\$ 1,032,403
Items not requiring (providing) operating cash flow		
Depreciation and amortization	3,523,183	3,391,464
Net unrealized and realized (gains) losses on investments	(1,090,130)	19,764
Restricted contributions	(33,255)	(673,687)
Loss on investment in equity investee	42,921	117,503
Changes in		
Patient accounts receivable	644,993	(1,633,514)
Other current assets and liabilities	<u>(877,033)</u>	<u>760,585</u>
Net cash provided by operating activities	<u>4,617,674</u>	<u>3,014,518</u>
Investing Activities		
Purchase of property and equipment	(1,959,281)	(1,991,696)
Proceeds from sale of property and equipment	19,500	—
Purchase of investments	(19,133,138)	(11,647,700)
Proceeds from disposition of investments	<u>19,573,453</u>	<u>11,736,499</u>
Net cash used in investing activities	<u>(1,499,466)</u>	<u>(1,902,897)</u>
Financing Activities		
Principal payments on long-term debt	(1,105,096)	(1,064,250)
Proceeds from restricted contributions	<u>33,255</u>	<u>673,687</u>
Net cash used in financing activities	<u>(1,071,841)</u>	<u>(390,563)</u>
Increase in Cash and Cash Equivalents	2,046,367	721,058
Cash and Cash Equivalents, Beginning of Year	<u>4,238,937</u>	<u>3,517,879</u>
Cash and Cash Equivalents, End of Year	<u>\$ 6,285,304</u>	<u>\$ 4,238,937</u>
Supplemental Cash Flows Information		
Interest paid during the year	\$ 397,946	\$ 437,274
Fixed assets additions in accounts payable	361,121	—
Capital lease obligation incurred for property and equipment	19,592	—

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements

September 30, 2010 and 2009

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

DeKalb Memorial Hospital, Inc. (Hospital), a not-for-profit organization, provides inpatient and outpatient health care services generally to residents of DeKalb County, Indiana and contiguous counties. Expenses relate to the provision of medical care and related general and administrative costs.

Use of Estimates

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

Cash and Cash Equivalents

The Hospital considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At September 30, 2010 and 2009, cash equivalents consisted primarily of money market accounts.

The financial institutions holding the Hospital's cash accounts are participating in the FDIC's Transaction Account Guarantee Program. Under the program, through December 31, 2012, all non-interest-bearing transaction accounts at these institutions are fully guaranteed by the FDIC for the entire amount in the account.

Interest-bearing accounts are insured by the FDIC up to \$250,000. At September 30, 2010, the Hospital's interest bearing cash accounts exceeded federally insured limits by approximately \$5,900,000.

Investments and Investment Return

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. The Hospital has classified substantially all of its investments in debt and equity securities as trading securities. The investment in equity investee is reported on the equity method of accounting. Investment return includes dividend, interest and other investment income and realized and unrealized gains and losses on investments carried at fair value.

Assets Limited as to Use

Assets limited as to use include (1) assets held by a trustee under terms of a bond indenture agreement, (2) assets restricted by donors and (3) assets set aside by the Board of Directors for future capital improvements over which the Board retains control and may at its discretion

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

subsequently use for other purposes. Amounts required to meet current liabilities of the Hospital, if any, are included in current assets.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Hospital bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Inventory

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

Property and Equipment

Property and equipment are recorded at cost and are depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

Patient Accounts Receivable Financing

Under a credit financing agreement, qualified self-pay patients can receive interest-bearing loans from an independent financial institution to pay their receivable balances to the Hospital. The transfer of these receivables is with full recourse to the Hospital. At September 30, 2010 and 2009, these receivables totaled \$437,821 and \$300,970, respectively. The Hospital has recorded a liability for estimated required repayments of \$0 on these loans at both September 30, 2010 and 2009.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Temporarily restricted net assets at September 30, 2010 and 2009, were available for the purchase of building improvements and equipment and operational expenses of various Hospital service lines.

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

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. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges forgone were \$831,680 and \$650,882 in 2010 and 2009, respectively.

Contributions

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

Estimated Malpractice Costs

The Hospital participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the Hospital, with the balance paid by the State of Indiana Patient Compensation Fund. The Hospital carries a claims-made basis insurance policy covering the Hospital's \$250,000 of exposure per claim with a \$5,000,000 annual aggregate. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claim experience, an accrual of \$75,000 has been made at September 30, 2010 and 2009, which is included in other accrued liabilities. It is reasonably possible that this estimate could change materially in the near term.

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

Pension Plan

The Hospital has a noncontributory defined contribution pension plan covering all eligible employees. The Hospital's cost each year is determined by the plan as a specific percentage of each participating employee's salary. It is the Hospital's policy to fund pension costs as accrued. Pension expense was \$1,221,607 and \$1,233,906 in 2010 and 2009, respectively.

Self Insurance

The Hospital has elected to self-insure certain costs related to employee health programs. Costs resulting from noninsured losses are charged to income when incurred. The Hospital has purchased insurance that limits its exposure for individual claims to \$80,000 per covered employee and that limits its aggregate exposure to \$3,400,000.

Income Taxes

The Hospital has been recognized as exempt from 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.

The Hospital files tax returns in the U.S. federal jurisdiction. With a few exceptions, the Hospital is no longer subject to U.S. federal examinations by tax authorities for years before 2007.

Excess (Deficiency) of Revenue Over Expenses

The statements of operations include excess (deficiency) of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

Reclassifications

Certain reclassifications have been made to the 2009 financial statements to conform to the 2010 presentation. These reclassifications had no effect on the change in net assets.

Note 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. These payment arrangements include:

Medicare. Inpatient acute care services and substantially all outpatient services provided to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment although determination of certain elements of the rates can occur after the current period and generate final settlement after submission of annual cost reports by the Hospital and audits thereof by the fiscal intermediary.

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

Medicaid. The Hospital is reimbursed for Medicaid inpatient and outpatient services at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Other Reimbursement Arrangements. The Hospital also has 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.

Approximately 40% and 39% of net patient service revenue are from participation in the Medicare program for the years ended September 30, 2010 and 2009, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

A summary of gross patient service revenue and contractual adjustments for the years ended September 30, 2010 and 2009, follows:

	<u>2010</u>	<u>2009</u>
Patient service revenue		
Routine services	\$ 8,209,927	\$ 7,415,061
Ancillary services		
Inpatient	13,396,153	11,770,029
Outpatient	66,168,710	58,927,443
Charity care	<u>(831,680)</u>	<u>(650,882)</u>
Total patient service revenue	86,943,110	77,461,651
Contractual adjustments	<u>(43,862,202)</u>	<u>(35,901,861)</u>
Net patient service revenue	<u>\$ 43,080,908</u>	<u>\$ 41,559,790</u>

Note 3: Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are area residents and are generally insured under third-party payer agreements. The mix of receivables from patients and third-party payers at September 30, 2010 and 2009, was:

	<u>2010</u>	<u>2009</u>
Commercial insurance	43%	41%
Medicare	26	23
Medicaid	5	9
Self-pay	22	24
Other	<u>4</u>	<u>3</u>
	<u>100%</u>	<u>100%</u>

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

Note 4: Investments and Investment Return

Assets Limited as to Use

Assets limited as to use at September 30, include:

	2010	2009
Cash and money market funds	\$ 1,350,895	\$ 2,194,608
Common stocks	70	69,314
Mutual funds		
Equity mutual funds	11,063,525	7,995,802
Fixed income mutual funds	<u>2,094,022</u>	<u>3,598,973</u>
	<u>\$ 14,508,512</u>	<u>\$ 13,858,697</u>
Internally designated	\$ 13,242,538	\$ 11,873,081
Externally restricted by donors	84,218	685,860
Held by trustee	<u>1,181,756</u>	<u>1,299,756</u>
	<u>\$ 14,508,512</u>	<u>\$ 13,858,697</u>

Total investment return is comprised of the following:

	2010	2009
Interest and dividend income	\$ 414,858	\$ 450,534
Realized gains (losses) on sales of securities	717,718	(1,431,445)
Unrealized gains (losses) on trading securities	372,412	(1,077,052)
Unrealized gains on other than trading securities	<u>—</u>	<u>2,488,733</u>
Total investment return	<u>\$ 1,504,988</u>	<u>\$ 430,770</u>

Total investment return is reflected in the statements of operations and changes in net assets as follows:

	2010	2009
Unrestricted net assets		
Other income (expense)	\$ 1,504,988	\$ (2,057,963)
Change in unrealized gains and losses on other than trading securities	<u>—</u>	<u>2,488,733</u>
	<u>\$ 1,504,988</u>	<u>\$ 430,770</u>

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

Effective October 1, 2008, the Hospital changed the accounting classification of substantially all of its investments in debt and equity securities from nontrading to trading. This change in classification requires the Hospital to recognize unrealized gains and losses on substantially all of its investments in debt and equity securities as nonoperating gains and losses in the statement of operations.

Previous to 2009, these investments had been classified as nontrading, and changes in the fair value of these investment securities were recorded as other changes in net assets. Accordingly, the cumulative amount of unrealized losses on investments at October 1, 2008, of \$2,488,733 has been included in unrealized losses in trading securities and removed from other changes in net assets within the 2009 statement of operations.

Note 5: Property and Equipment

Property and equipment at September 30 consists of:

	2010	2009	Estimated Useful Life
Land	\$ 220,118	\$ 220,118	
Land improvements	1,696,200	1,696,200	5-15 years
Hospital buildings	34,129,281	32,954,489	5-40 years
Medical office buildings	9,625,063	9,626,558	5-40 years
Equipment	16,674,321	16,945,747	5-20 years
Medical office equipment	55,281	60,893	5-20 years
Equipment held under capital lease	28,413	21,636	5 years
Construction in progress	631,455	70,237	
	63,060,132	61,595,878	
Less accumulated depreciation and amortization	(32,769,573)	(30,132,786)	
	\$ 30,290,559	\$ 31,463,092	

The Hospital has entered into capital leases for certain medical equipment. This equipment is included in property and equipment with an original cost of \$28,636 and \$28,413 and accumulated amortization of approximately \$4,735 and 20,215 at September 30, 2010 and 2009, respectively. The capital lease obligations are collateralized by the leased equipment.

Note 6: Investment in Equity Investee

The Hospital has a 50% ownership in a joint venture, which operates an occupational health clinic (RediMed DeKalb) in Auburn, Indiana. The Hospital accounts for the investment under the equity method of accounting. As a result, the Hospital recognized a loss of \$42,921 and \$117,503 related

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

to its investment in RediMed DeKalb for the years ended September 30, 2010 and 2009, respectively, which is included in other nonoperating income in the statements of operations.

The carrying value of this investment at September 30, 2010 and 2009, is a liability for approximately \$193,000 and \$150,000, respectively, related to losses in excess of the Hospital's investment in RediMed DeKalb.

Note 7: Medical Office Buildings

The Hospital owns medical office buildings (MOBs) adjacent to the Hospital, and leases space in these MOBs to physicians under various operating leases. Other revenue for the years ended September 30, 2010 and 2009, includes gross rental income of \$664,917 and \$587,719, respectively, from cancelable and noncancelable leases of the medical office building.

The following is a schedule, by year, of future minimum rental income to be received under operating leases which have initial or remaining noncancelable terms in excess of one year as of September 30, 2010:

2011	\$	131,083
2012		100,298
2013		87,960
2014		87,960
2015		87,960
Thereafter		<u>117,280</u>
	\$	<u>612,541</u>

Note 8: Long-Term Debt

Long-term debt at September 30, consists of the following:

	2010	2009
Hospital Authority of DeKalb County, Indiana, Revenue Bonds, Series 2006: Series A and B Bonds, payable through August 1, 2016, interest at 3.9% to 4.1% (A)	\$ 7,698,353	\$ 8,801,642
Capital lease obligation, at an imputed interest rate of 6.97%	<u>19,592</u>	<u>1,807</u>
	7,717,945	8,803,449
Less current maturities	<u>(1,149,456)</u>	<u>(1,096,017)</u>
	<u>\$ 6,568,489</u>	<u>\$ 7,707,432</u>

(A) The Hospital Authority of DeKalb County (Authority) was established in accordance with the Indiana Hospital Authority Act to issue tax-exempt revenue bonds for hospitals within

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

DeKalb County. Payments due under the bonds are made from amounts received by the Authority from the Hospital under a loan agreement. The Hospital's financial statements reflect the debt and related transactions of the Authority, on behalf of the Hospital, as if the Hospital had issued the tax-exempt bonds.

The Series 2006 Bonds mature serially in varying annual amounts through August 2016. At its option, the Hospital may redeem outstanding Series 2006 Bonds at any time on or after August 1, 2011.

The Loan Agreement for the Series 2006 Bonds grants a security interest in certain of the Hospital's real estate and portions of buildings, and contains certain covenants requiring the Hospital to maintain certain debt service coverage levels among other requirements.

Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at September 30, 2010, are:

2011	\$	1,149,456
2012		1,208,425
2013		1,248,289
2014		1,303,289
2015		1,368,289
Thereafter		<u>1,440,197</u>
	\$	<u>7,717,945</u>

Note 9: Disclosures About Fair Value of Assets and Liabilities

ASC Topic 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. The Hospital has no liabilities measured at fair value on a recurring basis. Additionally, the Hospital has no assets or liabilities measured at fair value on a nonrecurring basis.

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include money market funds, common stocks, equity mutual funds and fixed income mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. The Hospital has no Level 2 securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Hospital has no Level 3 securities.

The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2010 and 2009:

	2010			
	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments				
Money market funds	\$ 1,266,677	\$ 1,266,677	\$ —	\$ —
Common stocks	70	70	—	—
Equity mutual funds	11,063,525	11,063,525	—	—
Fixed income mutual funds	2,094,022	2,094,022	—	—

	2009			
	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments				
Money market funds	\$ 1,508,253	\$ 1,508,253	\$ —	\$ —
Common stocks	69,314	69,314	—	—
Equity mutual funds	7,995,802	7,995,802	—	—
Fixed income mutual funds	3,598,973	3,598,973	—	—

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

Note 10: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in Notes 1 and 2.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Note 1.

Regulatory Investigations

The U.S. Department of Justice, the Internal Revenue Service and other federal agencies routinely conduct regulatory investigations and compliance audits of health care providers. The Hospital is subject to these regulatory efforts. Management is currently unaware of any regulatory matters which may have a material adverse effect on the Hospital's financial position or results of operations.

Investments

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying balance sheets.

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations 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 counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. At September 30, 2010 and 2009, no accrual of potential losses from litigation was recorded. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Current Economic Conditions

The current protracted economic decline continues to present hospitals with difficult circumstances and challenges, which in some cases have resulted in large and unanticipated declines in the fair value of investments and other assets, constraints on liquidity and difficulty obtaining financing.

DeKalb Memorial Hospital, Inc.

Notes to Financial Statements September 30, 2010 and 2009

The financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values and allowances for accounts receivable that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.

Note 11: Related Party Transactions

The Hospital and DeKalb County Community Memorial Hospital Foundation, Inc. (Foundation) are related parties that are not financially interrelated organizations. The Foundation was established to receive and administer funds and to apply them for the acquisition, construction, establishment and operation of a Community Memorial Hospital for DeKalb County, Indiana. In the absence of donor restrictions, funds are distributed as determined by the Foundation's Board of Directors, which are separately appointed from that of the Hospital.

In 2010 and 2009, the Hospital received \$0 and \$600,000, respectively, in donations from the Foundation.

The Hospital has entered into various agreements in the normal course of business for services with companies for which certain officers of these companies are also members of the Hospital Board of Directors.

Note 12: Functional Expenses

The Hospital provides health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	<u>2010</u>	<u>2009</u>
Health care services	\$ 30,933,085	\$ 30,626,481
General and administrative	<u>12,975,368</u>	<u>12,646,845</u>
	<u>\$ 43,908,453</u>	<u>\$ 43,273,326</u>

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Notes to Financial Statements September 30, 2010 and 2009

Note 13: Construction Commitment

During 2010, the Hospital entered into a \$9,100,000 contract with an architectural firm to build out approximately 21,000 square feet in an existing facility and to construct approximately 6,000 square feet of additional space to house emergency department, imaging department and intensive care unit operations. At September 30, 2010, approximately \$8,790,000 had not been incurred on this project.

In September 2010, the Hospital entered into a commitment for the financing related to this project with a bank. The commitment is for \$9,000,000, with repayments of \$900,000 per year for an 11-year period due on the anniversary of the loan, plus interest paid monthly at the bank's prime rate less .26%. The commitment is to be collateralized by certain investments of the Hospital.

Note 14: Subsequent Events

In September 2010, the Hospital entered into an agreement to purchase a retail pharmacy and durable medical equipment provider for \$550,000 plus the cost of saleable inventory accepted at closing of the sale. The purchased operations are located on the Hospital's campus.

Subsequent events have been evaluated through November 19, 2010, which is the date the financial statements were issued.