

DeKalb Memorial Hospital, Inc.
d/b/a DeKalb Health

Accountants' Report and Consolidated Financial Statements

September 30, 2012 and 2011



DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
September 30, 2012 and 2011

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Independent Accountants' Report

Finance and Audit Committee
DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Auburn, Indiana

We have audited the accompanying consolidated balance sheets of DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health (Hospital) as of September 30, 2012 and 2011, and the related consolidated 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. d/b/a DeKalb Health as of September 30, 2012 and 2011, 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 20, 2012

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Consolidated Balance Sheets September 30, 2012 and 2011

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents	\$ -	\$ 2,974,361
Accounts receivable		
Patient services, net of allowance for uncollectible accounts; 2011 - \$862,642, 2010 - \$1,021,103	7,325,062	7,159,342
Other	1,010,961	447,704
Estimated amounts due from third-party payers	142,811	384,135
Inventories	1,324,144	903,158
Prepaid expenses and other	1,040,979	779,746
	10,843,957	12,648,446
Assets Limited as to Use		
Internally designated	15,473,760	12,995,464
Externally restricted by donor	108,889	112,897
Held by trustee	1,048,630	1,091,332
	16,631,279	14,199,693
Property and Equipment, net	40,357,773	36,986,222
Other Assets	236,926	91,838
Total assets	\$ 68,069,935	\$ 63,926,199
Liabilities and Net Assets		
Current Liabilities		
Outstanding checks in excess of bank balance	\$ 13,340	\$ -
Current maturities of long-term debt	2,155,533	1,235,563
Accounts payable	1,773,900	1,764,329
Accrued salaries, wages and related liabilities	3,025,630	2,347,591
Other accrued liabilities	1,265,064	721,302
	8,233,467	6,068,785
Long-Term Debt, less current maturities	9,403,556	10,785,896
Total liabilities	17,637,023	16,854,681
Net Assets		
Unrestricted	50,324,022	46,958,621
Temporarily restricted	108,890	112,897
Total net assets	50,432,912	47,071,518
Total liabilities and net assets	\$ 68,069,935	\$ 63,926,199

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Consolidated Statements of Operations
Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Unrestricted Revenue, Gains and Other Support		
Net patient service revenue	\$ 52,847,956	\$ 44,391,045
Other	8,422,687	5,264,472
Net assets released from restrictions used for operations	<u>26,862</u>	<u>34,031</u>
Total unrestricted revenue, gains and other support	<u>61,297,505</u>	<u>49,689,548</u>
Expenses		
Salaries and wages	22,707,202	19,662,631
Payroll taxes and employee benefits	7,304,573	5,887,115
Purchased medical services	3,853,732	3,889,193
Medical supplies and drugs	7,587,626	6,883,015
Insurance	584,120	546,910
Depreciation and amortization	4,140,062	3,805,396
Interest	453,184	233,109
Provision for uncollectible accounts	4,525,484	3,712,798
Other	<u>9,407,795</u>	<u>5,986,542</u>
Total expenses	<u>60,563,778</u>	<u>50,606,709</u>
Operating Income (Loss)	<u>733,727</u>	<u>(917,161)</u>
Other Income (Expense)		
Contributions received	58,534	3,382
Investment return, dividends, interest and realized gains	621,375	718,551
Investment return, change in unrealized gains (losses) on trading securities	1,908,412	(914,604)
Loss on investment in equity investee	<u>(10,491)</u>	<u>(13,669)</u>
Total other income (expense)	<u>2,577,830</u>	<u>(206,340)</u>
Excess (Deficiency) of Revenue over Expenses	3,311,557	(1,123,501)
Net assets released from restrictions used for purchase of property and equipment	<u>53,844</u>	<u>174,605</u>
Increase (Decrease) in Unrestricted Net Assets	<u>\$ 3,365,401</u>	<u>\$ (948,896)</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2012 and 2011

	2012	2011
Unrestricted Net Assets		
Excess (deficiency) of revenue over expenses	\$ 3,311,557	\$ (1,123,501)
Net assets released from restrictions used for purchase of property and equipment	53,844	174,605
Increase (decrease) in unrestricted net assets	3,365,401	(948,896)
Temporarily Restricted Net Assets		
Contributions received	76,699	237,315
Net assets released from restrictions	(80,706)	(208,636)
Increase (decrease) in temporarily restricted net assets	(4,007)	28,679
Increase (Decrease) in Net Assets	3,361,394	(920,217)
Net Assets, Beginning of Year	47,071,518	47,991,735
Net Assets, End of Year	\$ 50,432,912	\$ 47,071,518

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Consolidated Statements of Cash Flows Years Ended September 30, 2012 and 2011

	2012	2011
Operating Activities		
Change in net assets	\$ 3,361,394	\$ (920,217)
Items not requiring (providing) operating cash flows		
Depreciation and amortization	4,140,062	3,805,396
Loss on sale of property and equipment	-	17,752
Net realized and unrealized (gain) loss on investments	(2,091,805)	639,014
Restricted contributions	(76,699)	(237,313)
Loss on investment in equity investee	10,491	13,669
Changes in		
Patient accounts receivable	(165,720)	393,111
Other current assets and liabilities	214,153	(667,444)
	<u>5,391,876</u>	<u>3,043,968</u>
Net cash provided by operating activities		
Investing Activities		
Purchase of property and equipment	(4,856,504)	(9,881,029)
Proceeds from sale of property and equipment	-	6,000
Purchase of investments	(5,752,659)	(5,622,185)
Proceeds from disposition of investments	5,412,878	5,291,990
Acquisition of covenant not to compete	-	(539,782)
	<u>(5,196,285)</u>	<u>(10,745,006)</u>
Net cash used in investing activities		
Financing Activities		
Outstanding checks in excess of bank balance	(13,340)	-
Proceeds from issuance of long-term debt	522,000	-
Principal payments on long-term debt	(1,705,874)	(1,164,712)
Net change in line of credit	(2,076,117)	5,317,494
Proceeds from restricted contributions	76,699	237,313
	<u>(3,196,632)</u>	<u>4,390,095</u>
Net cash provided by (used in) financing activities		
Decrease in Cash and Cash Equivalents	(3,001,041)	(3,310,943)
Cash and Cash Equivalents, Beginning of Year	<u>2,974,361</u>	<u>6,285,304</u>
Cash and Cash Equivalents, End of Year	<u>#NAME?</u>	<u>\$ 2,974,361</u>
Supplemental Cash Flows Information		
Interest paid (net of amount capitalized)	\$ 445,701	\$ 225,626
Capital lease obligation incurred for property and equipment	2,797,621	150,732

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2012 and 2011

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

Nature of Operations and Principles of Consolidation

DeKalb Memorial Hospital, Inc., d/b/a DeKalb Health (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. The consolidated financial statements include the accounts of DeKalb Memorial Hospital, Inc., d/b/a DeKalb Health and its wholly owned subsidiary, DeKalb Memorial Pharmacare LLC (DMP), a not-for-profit limited liability company which operates a retail pharmacy within the Hospital facility. All significant intercompany balances and transactions have been eliminated in consolidation.

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.

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to \$250,000. At September 30, 2012, the Hospital's cash accounts did not exceed federally insured limits.

Pursuant to legislation enacted in 2010, the FDIC will fully insure all non-interest-bearing transaction accounts through December 31, 2012, at all FDIC-insured institutions.

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.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in unrestricted net assets. Other investment return is reflected in the statements of operations and changes in net assets as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2012 and 2011

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 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.

Inventories

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.

The Hospital capitalizes interest costs as a component of construction in progress, based on the weighted-average rates paid for long-term borrowing. Total interest incurred was:

	2012	2011
Interest costs capitalized	\$ 46,000	\$ 148,935
Interest costs charged to expense	453,184	233,109
Total interest incurred	\$ 499,184	\$ 382,044

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
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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, 2012 and 2011, these receivables totaled \$292,565 and \$170,358, respectively. The Hospital has recorded a liability for estimated required repayments of \$19,984 and \$38,826 on these loans at September 30, 2012 and 2011, respectively.

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, 2012 and 2011, were available for the purchase of building improvements and equipment and operational expenses of various Hospital service lines.

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 approximately \$874,000 and \$619,000 in 2012 and 2011, 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 temporarily restricted contributions and released from restriction.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2012 and 2011

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, including an estimate for claims incurred but not yet reported. Based upon the Hospital's claim experience, an accrual of \$75,000 has been made at September 30, 2012 and 2011, which is included in other accrued liabilities. It is reasonably possible that this estimate could change materially in the near term.

In 2012, the Hospital adopted the provisions of Accounting Standards Update (ASU) 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*. This ASU eliminates the practice of netting claim liabilities with expected related insurance recoveries for balance sheet presentation. As a result of the adoption of ASU 2010-24, the Hospital has recorded a long-term asset and liability of approximately \$490,000 included in other current assets and liabilities on the consolidated balance sheet as of September 30, 2012. There was no impact to the Hospital's consolidated results of operations or cash flows for the year ended September 30, 2012, as a result of the adoption of this guidance.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2012, the Hospital completed the first-year requirements under both the Medicare and Medicaid programs and has recorded revenue of approximately \$1,919,000, which is included in other revenue within operating revenues in the statement of operations.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements September 30, 2012 and 2011

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 approximately \$916,000 and \$870,000 in 2012 and 2011, 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 \$85,000 per covered employee and that limits its aggregate exposure to approximately \$4,750,000.

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 or state examinations by tax authorities for years before 2009.

The Hospital has elected to have DMP's income taxed as a partnership under provisions of the Internal Revenue Code and a similar section of the state income tax law. Therefore, taxable income or loss is reported to the Hospital for inclusion in its tax returns and no provision for federal and state income taxes is included in these statements.

DMP is subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for all periods since its inception in 2011.

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 (deficiency) of revenue over expenses, consistent with industry practice, include 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).

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

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2012 and 2011

settlement after submission of annual cost reports by the Hospital and audits thereof by the fiscal intermediary.

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.

In 2011, the state of Indiana submitted certain Medicaid State Plan Amendments to the Centers for Medicare and Medicaid Services (CMS) to incorporate a Provider Assessment Fee, requesting retroactive approval to July 1, 2011, which was approved by CMS in 2012. The effect of the Provider Assessment Fee on reimbursement is to increase Medicaid base fee for service and diagnosis related group payment rates to Indiana hospitals and reduce the level of Medicaid lump sum payments made under the existing Medicaid Supplemental Payment programs. For the year ended September 30, 2012, the Hospital paid Provider Assessment Fees of approximately \$2,077,000, of which approximately \$415,000 related to the September 30, 2011, calendar year, and received payments from the program of approximately \$3,493,000, of which approximately \$699,000 related to the September 30, 2011, calendar year, yielding a net increase to 2012 revenue in excess of expenses of approximately \$1,994,000, of which approximately \$283,000 relates to 2011. Provider Assessment Fee expense is included within other expenses and additional reimbursements received from the program are included within net patient service revenue on the 2012 consolidated statement of operations.

Approximately 39% and 40% of net patient service revenue is from participation in the Medicare program for the years ended September 30, 2012 and 2011, 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, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
Gross patient service revenue		
Routine services	\$ 11,012,651	\$ 9,805,629
Ancillary services		
Inpatient	14,986,805	13,777,407
Outpatient	80,918,880	69,539,915
Charity care	<u>(874,279)</u>	<u>(619,117)</u>
Total gross patient service revenue	106,044,057	92,503,834
Contractual adjustments	<u>(53,196,101)</u>	<u>(48,112,789)</u>
Net patient service revenue	<u>\$ 52,847,956</u>	<u>\$ 44,391,045</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2012 and 2011

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, 2012 and 2011, was:

	2012	2011
Commercial insurance	43%	38%
Medicare	19	19
Medicaid	4	5
Self-pay	26	32
Other	8	6
	100%	100%

Note 4: Investments and Investment Return

Assets Limited as to Use

Assets limited as to use at September 30, include:

	2012	2011
Cash and money market funds	\$ 1,238,415	\$ 1,251,672
Mutual funds		
Equity mutual funds		
Large blend and growth funds	5,934,655	4,401,001
Intermediate term growth funds	1,311,421	1,436,408
Small blend and growth funds	834,575	478,340
International funds	4,271,739	3,328,500
Other funds	969,519	1,130,790
Fixed income mutual funds	2,070,955	2,172,982
	\$ 16,631,279	\$ 14,199,693
Internally designated	\$ 15,473,760	\$ 12,995,464
Externally restricted by donors	108,889	112,897
Held by trustee	1,048,630	1,091,332
	\$ 16,631,279	\$ 14,199,693

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements September 30, 2012 and 2011

Total investment return is comprised of the following:

	2012	2011
Interest and dividend income	\$ 434,382	\$ 442,961
Realized gains on sales of securities	186,993	275,590
Unrealized gains (losses) on trading securities	1,908,412	(914,604)
Total investment return	\$ 2,529,787	\$ (196,053)

Note 5: Property and Equipment

Property and equipment at September 30 consists of:

	2012	2011	Estimated Useful Life
Land	\$ 393,118	\$ 220,118	
Land improvements	1,968,432	1,696,200	5-15 years
Hospital buildings	43,672,704	35,294,475	5-40 years
Medical office buildings	9,695,673	9,684,698	5-40 years
Equipment	20,708,722	17,954,785	5-20 years
Medical office equipment	55,281	55,281	5-20 years
Equipment held under capital lease	2,914,188	160,092	5 years
Construction in progress	225,281	7,846,904	
	79,633,399	72,912,553	
Less accumulated depreciation and amortization	(39,275,626)	(35,926,331)	
	\$ 40,357,773	\$ 36,986,222	

Note 6: Investment in Equity Investee

The Hospital has a 50% ownership in a joint venture, which operates an occupational health clinic (RediMed DeKalb LLC) in Auburn, Indiana. The Hospital accounts for the investment under the equity method of accounting. As a result, the Hospital recognized a loss of \$10,491 and \$13,669 related to its investment in RediMed DeKalb LLC for the years ended September 30, 2012 and 2011, respectively, which is included in other income (expense) category in the statements of operations.

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

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2012 and 2011

September 30, 2012 and 2011, includes gross rental income of approximately \$712,000 and \$707,000, 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, 2012:

2013	\$ 441,194
2014	296,706
2015	209,310
2016	<u>84,410</u>
	<u>\$ 1,031,620</u>

Note 8: Long-Term Debt

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

	<u>2011</u>	<u>2010</u>
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 5.0% (A)	\$ 5,351,775	\$ 6,550,065
Note payable to bank, maturity date of December 14, 2021 (B)	3,241,376	5,317,493
Note payable to third party, maturity date of June 1, 2016 to purchase land adjacent to campus	522,000	-
Capital lease obligations, at various imputed interest rates ranging from 2.26% to 6.97%	<u>2,443,938</u>	<u>153,901</u>
	11,559,089	12,021,459
Less current maturities	<u>(2,155,533)</u>	<u>(1,235,563)</u>
	<u>\$ 9,403,556</u>	<u>\$ 10,785,896</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 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.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements September 30, 2012 and 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.

- (B) In 2011, the Hospital entered into a \$9,000,000 revolving bank line of credit expiring in 2021. At September 30, 2011 there was \$5,317,493 borrowed against this line. The note is secured by certain investments. Available credit under the arrangement is reduced by \$900,000 per year starting on December 14, 2012.

Interest varies at a rate under, but based on the bank's prime rate, and was 2.99% on September 30, 2012. Interest on the note is payable monthly. The Hospital has the option to convert to a fixed interest rate during the term of the note at the following rates:

Beginning of note term through December 14, 2013	5.75%
December 15, 2014 to December 14, 2016	5.24
December 15, 2016 to December 14, 2018	4.65
December 15, 2018 to December 14, 2021	4.05

Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at September 30, 2012, are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2013	\$ 1,535,297	\$ 684,412
2014	1,385,007	640,348
2015	1,450,828	640,348
2016	1,494,353	573,393
2017	-	66,510
Thereafter	3,249,665	-
	<u>\$ 9,115,150</u>	<u>2,605,011</u>
Less amount representing interest		<u>(161,073)</u>
Present value of future minimum lease payments		2,443,938
Less current maturities		<u>(620,236)</u>
Noncurrent portion		<u>\$ 1,823,702</u>

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Property and equipment include the following property under capital leases:

	2012	2011
Equipment	\$ 2,914,188	\$ 160,092
Less accumulated depreciation	(401,542)	(30,666)
	\$ 2,512,646	\$ 129,426

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.

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, 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.

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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, 2012 and 2011:

	2012				
	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	\$ 1,129,526	\$ 1,129,526	\$ -	\$ -	
Equity mutual funds					
Large blend and growth funds	5,934,655	5,934,655	-	-	
Intermediate term growth funds	1,311,421	1,311,421	-	-	
Small blend and growth funds	834,575	834,575	-	-	
International funds	4,271,739	4,271,739	-	-	
Other funds	969,519	969,519	-	-	
Fixed income mutual funds	2,070,955	2,070,955	-	-	
	2011				
	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	\$ 1,138,775	\$ 1,138,775	\$ -	\$ -	
Equity mutual funds					
Large blend and growth funds	4,401,001	4,401,001	-	-	
Intermediate term growth funds	1,436,408	1,436,408	-	-	
Small blend and growth funds	478,340	478,340	-	-	
International funds	3,328,500	3,328,500	-	-	
Other funds	1,130,790	1,130,790	-	-	
Fixed income mutual funds	2,172,982	2,172,982	-	-	

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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, 2012 and 2011, no accrual of potential losses from litigation was recorded other than in relation to the Hospital's estimated malpractice insurance costs as discussed in Note 1. 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

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value of investments and other assets, constraints on liquidity and difficulty obtaining financing. 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 2012, the Hospital received no donations from the Foundation. In 2011, the Hospital received \$162,000 in donations from the Foundation.

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>2012</u>	<u>2011</u>
Health care services	\$ 52,053,119	\$ 45,143,119
General and administrative	<u>6,433,531</u>	<u>5,463,590</u>
	<u>\$ 58,486,650</u>	<u>\$ 50,606,709</u>

Note 13: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Accountants' Report, which is the date the financial statements were available to be issued.