CONSOLIDATED FINANCIAL STATEMENTS

Goshen Health System, Inc. and Subsidiaries
Years Ended December 31, 2007 and 2006
With Report of Independent Auditors

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Consolidated Financial Statements

Years Ended December 31, 2007 and 2006

Contents

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Report of Independent Auditors

The Board of Directors
Goshen Health System, Inc.

We have audited the accompanying consolidated balance sheets of Goshen Health System, Inc. and Subsidiaries (the System) as of December 31, 2007 and 2006, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the System'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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the System's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 consolidated financial position of Goshen Health System, Inc. and Subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and changes in their net assets and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 6, 2008

Goshen Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2007	**2006**
Assets		
Current assets:		
Cash and cash equivalents	**$ 5,323,197**	$ 5,083,900
Short-term investments	**8,436,000**	8,106,000
Patient accounts receivable, less allowance for doubtful accounts of $7,134,000 and $6,828,000 in 2007 and 2006, respectively	**21,070,549**	21,528,753
Prepaid expenses and other	**2,391,697**	2,980,179
Inventories	**4,359,472**	3,444,485
Total current assets	**41,580,915**	41,143,317
Assets limited as to use:		
Board-designated investment funds	**33,809,700**	36,434,573
Property and equipment:		
Land and land improvements	**4,848,314**	4,845,841
Buildings and improvements	**73,837,319**	53,719,569
Equipment	**76,057,332**	67,085,521
Construction in progress	**819,620**	14,708,554
Property held for expansion	**1,177,498**	1,064,263
	156,740,083	141,423,748
Less accumulated depreciation	**63,483,686**	53,947,791
Total property and equipment, net	**93,256,397**	87,475,957
Other assets:		
Annuity contracts	**943,065**	809,383
Goodwill, net of accumulated amortization of approximately $2,064,300 and $1,937,816 in 2007 and 2006, respectively	**532,620**	659,136
Equity interest in unconsolidated organizations	**2,554,896**	–
Other assets	**141,247**	163,132
Total other assets	**4,171,828**	1,631,651
Total assets	**$ 172,818,840**	$ 166,685,498

	December 31	
	2007	**2006**
Liabilities and net assets		
Current liabilities:		
Current maturities of Clarian Health corporate loans	**$ 1,020,812**	$ 488,683
Current portion of notes payable	**112,500**	112,450
Current portion of capital lease obligations	**352,305**	423,009
Accounts payable and accrued expenses	**7,131,851**	11,203,548
Salaries, wages, and related liabilities	**7,480,786**	6,460,170
Estimated third-party payor settlements	**1,582,000**	1,349,000
Total current liabilities	**17,680,254**	20,036,860
Noncurrent liabilities:		
Clarian Health corporate loans, less current maturities	**44,534,475**	45,798,239
Notes payable, less current portion	**1,978,125**	2,090,675
Capital lease obligations, less current portion	**–**	352,306
Deferred medical professional fees	**943,065**	809,383
Other liabilities	**718,848**	683,023
Total noncurrent liabilities	**48,174,513**	49,733,626
Total liabilities	**65,854,767**	69,770,486
Net assets:		
Unrestricted	**106,546,703**	96,915,012
Temporary restricted	**417,370**	–
Total net assets	**106,964,073**	96,915,012
Total liabilities and net assets	**$ 172,818,840**	$ 166,685,498

See accompanying notes.

Goshen Health System, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended December 31	
	2007	**2006**
Revenue:		
Net patient service revenue	**$ 166,277,049**	$ 150,634,005
Other revenue	**4,968,231**	4,342,290
Total operating revenue	**171,245,280**	154,976,295
Expenses:		
Salaries and wages	**62,697,878**	57,090,745
Colleague benefits	**18,456,638**	17,532,247
Supplies, drugs, purchased services, and other	**58,668,068**	50,618,006
Provision for bad debts	**13,968,766**	13,239,177
Depreciation and amortization	**10,047,687**	7,783,039
Interest	**2,239,647**	1,846,962
Total operating expenses	**166,078,684**	148,110,176
Operating income	**5,166,596**	6,866,119
Nonoperating gains and (losses):		
Investment income	**3,307,946**	3,248,625
Changes in net unrealized gains/losses on investments	**1,069,329**	914,788
Other gains, net	**87,820**	249,043
Nonoperating gains, net	**4,465,095**	4,412,456
Excess of revenue over expenses	**9,631,691**	11,278,575
Recognition of asset retirement obligation, net	**–**	(200,197)
Increase in unrestricted net assets	**9,631,691**	11,078,378
Temporarily restricted net assets:		
Gifts and other	**417,370**	–
Increase in net assets	**10,049,061**	11,078,378
Net assets, beginning of year	**96,915,012**	85,836,634
Net assets, end of year	**$ 106,964,073**	$ 96,915,012

See accompanying notes.

Goshen Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2007	**2006**
Operating activities		
Increase in net assets	**$ 10,049,061**	$ 11,078,378
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	**10,047,687**	7,783,039
Provision for bad debts	**13,968,766**	13,239,177
Changes in operating assets and liabilities:		
Patient accounts receivable	**(13,510,562)**	(14,675,379)
Prepaid expenses and other assets	**(1,944,529)**	(1,144,795)
Inventories	**(914,987)**	(580,919)
Trading securities	**2,294,873**	13,311,451
Accounts payable and accrued expenses	**(4,071,697)**	4,805,072
Salaries, wages, and related liabilities	**1,020,616**	1,355,949
Estimated third-party payor settlements	**233,000**	301,000
Other liabilities	**35,825**	282,366
Net cash provided by operating activities	**17,208,053**	35,755,339
Investing activities		
Purchases of property and equipment	**(15,701,611)**	(31,881,186)
Net cash used in investing activities	**(15,701,611)**	(31,881,186)
Financing activities		
Proceeds from issuance of note payable	**–**	2,250,000
Proceeds from Clarian Health corporate loans	**–**	23,800,000
Principal payments – loans and notes payable	**(844,135)**	(511,038)
Principal payments – capital leases	**(423,010)**	(429,183)
Net cash (used in) provided by financing activities	**(1,267,145)**	25,109,779
Net increase in cash and cash equivalents	**239,297**	2,361,030
Cash and cash equivalents, beginning of year	**5,083,900**	2,722,870
Cash and cash equivalents, end of year	**$ 5,323,197**	$ 5,083,900
Supplemental disclosures of cash flow information		
Cash paid during the year for:		
Interest, net of amounts capitalized	**$ 2,239,647**	$ 1,846,962
Income taxes	**$ 71,931**	$ 42,452

See accompanying notes.

The mission and values of Goshen Health System, Inc:

The mission of Goshen General Hospital is to improve the health of our communities by providing innovative, outstanding care and services, through exceptional people doing exceptional work.

Compassion - and commitment to serve with empathy.

Accountability - with integrity and action.

Respect - through treating others as you wish to be treated.

Excellence - in all we do.

1. Organization and Nature of Operations

Goshen Health System, Inc. (the Parent), an Indiana not-for-profit corporation, is the sole corporate member of Goshen Hospital Association, Inc. (the Hospital) and is the sole shareholder of Parkmor Drug, Inc. and Subsidiaries (Park), collectively, the System. Effective April 1, 2000, Clarian Health Partners, Inc. (Clarian Health), an Indiana not-for-profit corporation, became the sole member of the System.

The Hospital is a not-for-profit, acute-care hospital serving Goshen, Indiana, and surrounding communities in northern Indiana. Park is a for-profit corporation, which owns and operates a home medical equipment business located in Goshen, Indiana. The Parent owns and operates physician practices located in the Hospital's service area, which is referred to as PrimeCare Physician Network (PrimeCare). The accompanying consolidated financial statements of Goshen Health System, Inc. and Subsidiaries include the accounts of the Parent (including PrimeCare), the Hospital, and Park.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying financial statements include the accounts of the System. All majority-owned corporations are consolidated and all significant inter-entity transactions have been eliminated in consolidation. Investments in entities where the System owns 50% or less and does not have significant operational influence are recorded under the equity method (see Note 9). Under the equity method, original investments are recorded at cost and adjusted for the System's share of undistributed earnings or losses of these joint ventures. Equity in income or loss of joint ventures is included in other nonoperating gains (losses), net in the accompanying consolidated statements of operations and changes in net assets.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Patient Service Revenue

For the years ended December 31, 2007 and 2006, approximately 41% of the System's gross patient service revenue is derived under the Medicare program. For the years ended December 31, 2007 and 2006, 17% and 16%, respectively, is derived from another third-party payor. These programs and other contracted programs provide for payments to the System at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payors due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period that the services are rendered, and such amounts are adjusted in future periods, as adjustments become known.

2. Summary of Significant Accounting Policies (continued)

Reported costs and services provided under the reimbursement arrangements with Medicare and Medicaid are subject to retroactive audits and adjustments. Provision has been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between the standard charges for services and estimated total payments to be received from third-party payors. Estimated settlements are accrued in the period the related services are rendered and adjusted in future periods as final settlements are determined. During 2007 and 2006, the System settled prior years' Medicare liabilities for amounts less than previously estimated. The effect of these settlements was to increase net patient service revenues by $955,000 and $1,057,000 in 2007 and 2006, respectively. Laws and regulations governing these programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility recorded estimated settlements could change by a material amount in the future. Management believes that adequate provisions have been made for any adjustments that may result from such final settlements.

Other Revenue

Other revenue primarily consists of Park's home medical equipment sales and the Hospital's cafeteria sales. Other revenue also includes contributions of $182,000 in 2007.

Other Gains, Net

Other gains, net primarily consist of rental income.

Fair Values of Financial Instruments

Financial instruments include cash and cash equivalents, short-term investments, patient accounts receivable, assets limited as to use, accounts payable and accrued expenses, salaries, wages and related liabilities, estimated third-party settlements, current and long-term debt, and certain other assets and liabilities. The fair values for cash and cash equivalents, short-term investments, patient accounts receivable, accounts payable and accrued liabilities, salaries, wages and related liabilities, estimated third-party settlements, and certain other assets and liabilities approximate the carrying amounts reported in the consolidated balance sheets. The fair values for assets limited as to use and current and long-term debt are described in Notes 3 and 4, respectively.

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents represent cash and temporary investments with maturities of three months or less when purchased, excluding amounts whose use is limited by board designation.

Short-Term Investments

Short-term investments include highly liquid corporate bonds and notes. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law.

Assets Limited as to Use

Assets limited as to use include $1,409,000 and $1,257,000 at December 31, 2007 and 2006, respectively, of assets designated by the Board of Directors (the Board) for the System's cancer program with the remainder for future capital improvements and physician research, which the Board retains control and may, at its discretion, subsequently use for other purposes.

The fair value of assets limited as to use is estimated based on quoted market prices for those or similar investments. Realized gains and losses and interest and dividend income are included in investment income in the accompanying consolidated statements of operations and changes in net assets. Management considers all investments to be trading and, accordingly, all unrealized gains and unrealized losses are recorded as changes in nonoperating gains and losses in the accompanying consolidated statements of operations and changes in net assets. The cost of securities sold is based on the specific-identification method.

Patient Accounts Receivable

The System grants credit to patients, substantially all of whom are residents of Goshen, Indiana, and the surrounding communities, and does not require collateral or other security for the provision of services. However, assignment of benefit payments payable under patient's health insurance programs and plans (e.g., Medicare, Medicaid, health maintenance organizations, and commercial insurance policies) is routinely obtained as an industry practice.

2. Summary of Significant Accounting Policies (continued)

The provision for bad debts is based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Periodically, management assesses the adequacy of the allowance for doubtful accounts based upon estimated write-off experience by payor category and aging. The results of this review are then used to make any modifications to the provision for bad debts to establish an appropriate allowance for doubtful accounts. In addition, the System has established guidelines for placing certain past due patient balances with collection agencies.

Inventories

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

Property and Equipment

Property and equipment are stated at cost. Depreciation is determined by the straight-line method over the estimated useful lives of the assets. Such lives range as follows: land improvements (15 to 20 years), building and improvements (20 to 30 years), and equipment (3 to 7 years). Equipment under capital lease obligations is amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation and amortization in the consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets, when considered material by management. Depreciation expense, including the amortization from capital leases, for the years ended December 31, 2007 and 2006, is approximately $9,945,000 and $7,657,000, respectively. Depreciation and amortization expense as presented in the consolidated statements of operations and changes in net assets includes depreciation of assets, amortization of capital leases, and goodwill.

The System periodically evaluates whether circumstances have occurred that would indicate whether the remaining estimated useful lives of long-lived assets may warrant revision or that the remaining balance of such assets may not be recoverable. When factors indicate that such assets should be evaluated for possible impairment, an estimate is made of the undiscounted cash flows over the remaining lives of the assets in measuring whether the assets are recoverable in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*

2. Summary of Significant Accounting Policies (continued)

Goodwill

Goodwill relates principally to the purchase of Michiana Regional Oncology Associate, LLC and represents the excess of the purchase price over the fair value of net assets acquired. All goodwill is being amortized on the straight-line basis over a 10-year period. Amortization on goodwill for the years ended December 31, 2007 and 2006, was $102,000.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those assets whose use by the System has been limited by donors to a specific time period or purpose. These net assets are restricted to support research efforts in the Center for Cancer Care.

Contributions

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. When the restriction of a temporarily restricted contribution is satisfied in the same reporting period as it is received, it is reported as unrestricted support if it is a program restriction or unrestricted net assets if it is a capital expenditure restriction.

2. Summary of Significant Accounting Policies (continued)

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital has determined such amounts to qualify as charity care, they are not reported as revenue. Charges forgone, based on established rates, approximated $1,757,000 and $3,398,000, for the years ended December 31, 2007 and 2006, respectively.

Income Taxes

The Parent and the Hospital are not-for-profit organizations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Park is a for-profit corporation. For the year ended December 31, 2007, an income tax benefit of approximately $72,000 was recognized related principally to previously unrecognized net operating loss credit carryforwards. For the year ended December 31, 2006, an income tax benefit of approximately $42,500 was recognized related principally to previously unrecognized net operating loss credit carryforwards. At December 31, 2007 and 2006, deferred income taxes were not significant.

In June 2006, Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), an interpretation of SFAS No. 109, *Accounting for Income Taxes*, was issued. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS No. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting for interim periods, disclosure, and transition. This standard became effective for the System during the year ended December 31, 2007. Compliance with this standard had no material impact on the consolidated financial statements of the System.

Asset Retirement Obligations

The System accounts for the fair value of legal obligations associated with long-lived asset retirements in accordance with SFAS 143, *Accounting for Asset Retirement Obligations*, and FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47).

2. Summary of Significant Accounting Policies (continued)

The asset retirement obligation, recorded in other noncurrent liabilities, is accreted to the present value at the end of each period. The fair value of the obligation at December 31, 2007 and 2006, was $220,000 and $208,000, respectively, of which $200,000 was recorded in 2006 as a decrease in unrestricted net assets.

Operating Indicator (Operating Income)

Operating income includes all unrestricted revenue, gains and other support, and expenses directly related to the recurring and ongoing health care operations of the System during the reporting period. The operating indicator excludes investment returns and unrealized changes in investment values, and other gains and losses deemed by management not to be directly related to providing health care services.

Performance Indicator (Excess of Revenues Over Expenses)

Excess of revenues over expenses includes operating income and changes in unrestricted net assets related to results of treasury operations of the System (consisting of interest and dividend income on investments, gains and losses on the sale of investments, and unrealized investment gains and losses) and other activities not directly related to the provision of health care services. Excluded from the performance indicator are asset transfers from (to) affiliates, contributions for capital expenditures, discontinued operations, and the impact of the adoption of certain new accounting standards.

Recent Accounting Standards Not Required for 2007

In September 2006, SFAS No. 157, *Fair Value Measurements* was issued. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. SFAF No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of unrestricted net assets in the year of adoption.

2. Summary of Significant Accounting Policies (continued)

The System adopted SFAS No. 157 on January 1, 2008. The adoption did not have a material impact on the System's consolidated financial position or consolidated results of operations.

Reclassifications

The accompanying consolidated financial statements for the years ended December 31, 2007 and 2006, have been reclassified to reflect a correction in the classification of unrealized gains and losses on investments. In previous years, all of the System's investments were classified as other than trading. As such, unrealized gains, as well as unrealized losses that were considered temporary, were excluded from the excess of revenue over expenses. During 2007, the System determined that substantially all of its investment portfolio was more accurately classified as trading, with unrealized gains and losses included in the determination of the excess of revenue over expenses. Therefore, the consolidated financial statements have been changed to reflect the unrealized gains and losses on investments during the years ended December 31, 2007 and 2006, as a component of the excess of revenue over expenses. These reclassifications had no effect on unrestricted net assets or total net assets.

The result of the reclassification increased the excess of revenue over expenses by $914,788 for the year ended December 31, 2006, and had no impact on the balance of unrestricted net assets at December 31, 2006. In connection with the reclassification, certain amounts were removed from investing activities on the consolidated statement of cash flows. For the year ended December 31, 2006, this resulted in an increase of $11,154,457 to operating cash flows and an offsetting decrease to investing cash flows.

3. Assets Limited as to Use

Assets limited as to use include funds designated by the Board for capital improvements. The composition of assets limited as to use at December 31 is as follows:

	2007	2006
Cash and cash equivalents	**$ 147,417**	$ 8,500,078
U.S. government securities	**–**	98,550
Corporate bonds	**354,273**	455,807
Equity mutual funds	**21,486,002**	18,228,185
Corporate bonds and fixed mutual funds	**9,691,349**	8,626,719
Hedge funds	**2,130,659**	525,234
	$ 33,809,700	$ 36,434,573

Investment income and net unrealized gains on investments are comprised of the following for the years ended December 31:

	2007	2006
Investment income from joint ventures	**$ 39,586**	$ 56,844
Investment income:		
Interest and dividend income	**1,879,265**	1,949,575
Realized gains on sales of investments, net	**1,389,095**	1,242,206
Changes in net unrealized gains/losses on investments	**1,069,329**	914,788
	$ 4,377,275	$ 4,163,413

4. Clarian Health Corporate Loans

Clarian Health corporate loans consist of the following:

	2007	2006
Loan due in monthly principal installments of $37,635, including interest at 6.05%, with final maturity in November 2030	**$ 5,582,975**	$ 5,693,182
Loan due in monthly principal installments of $9,632, including interest at 6.05%, with final maturity in November 2030	**1,428,892**	1,457,098
Loan due in monthly principal installments of $24,112, including interest at 6.05%, with final maturity in December 2030	**3,583,005**	3,653,259
Loan due in monthly principal installments varying from $20,893 to $21,771, plus variable interest ranging from 3.8% to 4.2% at December 31, 2007, and 2.0% to 3.3% at December 31, 2006, with final maturity in November 2030	**11,403,375**	11,683,383
Loan principal payments start in December 2007; semi-annual installments thereafter, with final maturity due June 2030; interest at 5.54%	**23,557,040**	23,800,000
	45,555,287	46,286,922
Less current portion	**1,020,812**	488,683
	$ 44,534,475	$ 45,798,239

In November 2000, the Indiana Health Facility Financing Authority issued $352,000,000 of Series 2000 Hospital Revenue Bonds (the Bonds) on behalf of the Clarian Health Obligated Group (the Obligated Group). The Obligated Group is composed of Clarian Health and LaPorte Regional Health System, Inc. and Subsidiaries (LaPorte), a Clarian Health subsidiary. The Obligated Group is subject to certain financial performance covenants, among other compliance requirements, that require the maintenance of debt service ratios and limit the Obligated Group's ability to encumber certain of its assets. In connection with the issuance of the Bonds, the System entered into a Participation Agreement (the Agreement) with Clarian Health, which designates the Hospital and the Parent as Obligated Group Affiliates (Affiliates) and a Participating System Group. As such, the Hospital received $25 million of the proceeds of the Bonds to be used for capital expenditures and to defease bonds.

4. Clarian Health Corporate Loans (continued)

Any payment default on the Bonds under the Clarian Health Obligated Group Master Indenture (the Master Indenture) will be allocated pro rata to the other Participating System Groups based on the respective principal amounts of the loans not in default.

During January 2006, Clarian Health issued, through the Indiana Health and Education Facility Financing Authority, Hospital Revenue Bonds, Series 2006A, tax-exempt bonds in the aggregate amount of $327,170,000. The bond proceeds are being used principally to finance construction or refurbishment of Clarian facilities owned or operated by members of the Obligated Group or Obligated Group Affiliates and to pay capitalized interest and certain costs to issue the bonds.

On January 24, 2006, the System borrowed $23,800,000 from Clarian Health at a fixed rate of 5.54%. The proceeds were provided from Clarian Health's Hospital Revenue Bonds, Series 2006A. These borrowed funds are being used to provide improved patient access and expand the Hospital's Intensive Care Unit, Emergency Department, and Surgery Department.

As Affiliates, the Parent and the Hospital are subject to compliance with all provisions of the Master Indenture pertaining to Affiliates, including the performance and observance of all financial covenants and obligations of Affiliates under the Master Indenture. As of December 31, 2007, the Parent and the Hospital believe they are in compliance with all financial covenants. Total interest expense incurred in 2007 and 2006 related to the Clarian Health corporate loans was approximately $2,430,000 and $2,239,000, respectively. Interest capitalized during the years ended December 31, 2007 and 2006, was $334,000 and $606,000, respectively.

The total amount outstanding for all Clarian Health Partners, Inc. Hospital Revenue Bonds at December 31, 2007, was $1,420,810,000.

The estimated fair value of the System's Clarian Health corporate loans at December 31, 2007, is approximately $45,148,241 based on market interest rates for similar issues.

4. Clarian Health Corporate Loans (continued)

Annual maturities of Clarian Health corporate loans are as follows for the years ending December 31:

2007	$ 1,020,812
2008	1,076,521
2009	1,135,301
2010	1,197,328
2011	1,250,019
Thereafter	39,875,306
	$ 45,555,287

5. Note Payable

In June 2006, the System entered into a term note with a bank to borrow $2,250,000. This loan is payable over 10 years at an interest rate of LIBOR plus 1.25% per annum, with the remaining unpaid balance of all principal and accrued interest due and payable on June 1, 2016. The average interest rate on the note for the year ended December 31, 2007 and 2006, was 5.67% and 6.59%, respectively. The note is secured by a mortgage lien on real property in Shipshewana, Indiana, and by an assignment of leases and rents relating to that real property. The carrying value of this property was approximately $2,203,000 at December 31, 2007. Annual maturities are as follows for the years ending December 31:

2008	$ 112,500
2009	112,450
2010	112,450
2011	112,450
2012	112,450

6. Capital Lease Obligations

Capital lease obligations consist of the following:

	2007	2006
Obligations, at varying rates of imputed interest from 2.5% to 4.3% collateralized by leased equipment with a cost of $2,927,771 and accumulated depreciation of $2,732,492	**$ 352,305**	$ 775,315
Less current portion	**352,305**	423,009
	$ –	$ 352,306

7. Deferred Medical Professional Fees

The Hospital provides a plan, administered by the American Hospital Association, Inc., which allows medical professionals to defer payment of fees earned by them. The obligation of the Hospital, which was approximately $943,065 and $809,383 at December 31, 2007 and 2006, respectively, is calculated by means of a formula based on the fees deferred and certain annuity assumptions.

The Hospital has purchased annuity contracts to use in settlement of its obligations referred to above. The cash surrender value of the annuity contracts at December 31, 2007 and 2006, was approximately $943,065 and $809,383, respectively.

8. Retirement Plans

The System offers a defined-contribution retirement plan to qualifying colleagues (employees). To qualify, a colleague must be at least 21 years of age and have 1,000 hours of service during the calendar year. The System's annual contributions to the plan are based upon a specific percentage of each participating colleague's salary, reduced by credits arising from the termination or death of colleagues who are not fully vested. Plan expense was $2,472,131 and $1,902,920 for the years ended December 31, 2007 and 2006, respectively.

9. Affiliations

Joint Ventures

The Hospital has entered into operating agreements with certain physicians to operate commercial rental buildings that house the New Paris and Nappanee clinic operations. The real estate ventures are equally owned and jointly governed by the Hospital and the physicians. The Hospital's investment in these joint ventures is as follows at December 31:

	2007	**2006**
New Paris Clinic, LLC	**$ 71,000**	$ 77,000
Nappanee Clinic, LLC	**71,000**	86,000
	$ 142,000	$ 163,000

In addition, the Hospital owns a 50% interest in Indiana Lakes Managed Care Organization, LLC (ILMCO). ILMCO provides management services for managed care arrangements entered into by its members and third parties. In 2001, the Hospital recorded an impairment loss to fully reserve its investment in ILMCO as management determined that changes in ILMCO's contracts made it unlikely that it would generate positive future cash flows.

9. Affiliations (continued)

Clarian Health Partners, Inc.

As outlined in the Integration Definitive Agreement (the IDA), Clarian Health is the sole corporate member of the System and has limited approval powers for matters relating to the System, as described in the IDA. In addition, the System is required to maintain specific minimum financial ratios and operational standards. In return, Clarian Health is to perform certain measures including making certain funds available to the System to support the implementation of the affiliation. Additionally, the System incurred approximately $19,347 and $25,463 in 2007 and 2006, respectively, for corporate compliance and internal audit services purchased from Clarian Health.

10. Concentrations of Credit Risk

The Hospital and PrimeCare grant credit without collateral from its patients, most of whom are local residents and are insured under third-party payor agreements. The composition of net receivables from patients and third-party payors at December 31 is as follows:

	2007	**2006**
Managed care and other third-party payors	**31%**	40%
Patients	**30**	29
Medicare	**14**	16
Specific third-party payor	**23**	14
Medicaid	**2**	1
	100%	100%

11. Commitments and Contingencies

Malpractice Insurance

Effective September 1, 2002, the System began participation in the Clarian Health Partners, Inc. medical malpractice program, including coverage offered by CH Risk Retention Group, Inc. (the Group), a South Carolina-based risk retention group that is virtually wholly owned by Clarian Health (or, from September 1, 2002 to June 30, 2005, by the frontage carrier Continental Casualty Company). The Group's liabilities are ceded to the reinsurer, CH Assurance, LTD, a captive insurance company wholly owned by Clarian Health. Coverage is provided on a claims-made basis for the Hospital and on an occurrence basis for PrimeCare. Should the claims-made policy not be renewed, replaced with equivalent insurance, or tail coverage purchased, claims based on occurrences during its terms but reported subsequently would be uninsured. The System has recorded an actuarially determined amount of approximately $498,340 and $424,000 at December 31, 2007 and 2006, respectively, for this estimated liability which is included in other liabilities on the accompanying balance sheets. The System incurred expenses of $1,126,956 for this coverage in 2007 and $1,577,000 in 2006.

Under the Clarian Health Partners, Inc. medical malpractice program, commercial insurance carriers also provide reinsurance for certain excess general liability coverage, on a claims-made basis (aggregating $40,000,000), of the captive insurance company. The System's medical malpractice coverage considers limitations imposed by the Indiana Medical Malpractice Act (the Act). Effective July 1, 1999, the Act limits the amount of individual claims to $1.25 million, of which $1 million would be paid by the State of Indiana Patient Compensation Fund (the Fund), and the first $250,000 per occurrence and up to $7.5 million in the annual aggregate would be the responsibility of CH Assurance, LTD.

Through the normal course of operations, the System is subject to claims alleging professional malpractice. In the opinion of management, the ultimate disposition of claims incurred to date will not have a material adverse effect on the financial position or operations of the System.

11. Commitments and Contingencies (continued)

Operating Leases

The System leases various facilities under operating leases expiring at various dates. Total rental expense for all operating leases was approximately $1,076,556 and $1,996,155 for the years ended December 31, 2007 and 2006, respectively. Future minimum lease commitments under all operating leases are as follows:

2008	$ 1,618,901
2009	1,441,532
2010	640,011
2011	385,550
2012	83,521
	$ 4,169,515

Self-Insurance

The System is self-insured for health insurance claims in annual amounts up to $100,000 per individual. The System accrues an estimated liability for incurred but not reported claims based upon an analysis of historical claims data and information provided by the third-party administrator. This liability totaled $1,747,000 and $1,561,000 at December 31, 2007 and 2006, respectively, and is included in salaries, wages and related liabilities in the accompanying balance sheets.

Receivables Financed With Recourse

The System has an arrangement with a local bank to finance certain patient accounts receivable, with recourse to the System if the guarantor does not pay such amounts. Such receivables totaled approximately $547,626 and $606,912 at December 31, 2007 and 2006, respectively.

11. Commitments and Contingencies (continued)

Guarantees

On June 2, 2004, the System executed a continuing limited guaranty on a term loan extended to Nappanee Clinic totaling $2,847,976 for the sole purchase of a commercial rental building. If Nappanee Clinic fails to pay interest and other payments when due, the bank may declare all amounts due and payable upon request. The guaranty is limited to 50% of the principal amount of the term loan plus accrued interest and the bank's reasonable attorneys' fees, legal costs, and other necessary out-of-pocket expenses incurred to enforce this guaranty. At December 31, 2007, the System guarantees $1,294,583 of the term loan.

Construction

At December 31, 2007, the System had commitments totaling approximately $535,492 related to construction and modernization projects that are expected to be completed during the next two years.

12. Functional Expenses

The System provides inpatient and outpatient health care services, physician services, and home medical supplies and equipment to its surrounding communities. Expenses related to providing these services and products are as follows for the years ended December 31:

	2007	**2006**
Health care services	**$144,721,699**	$128,681,778
Home medical supplies and equipment	**843,987**	710,849
General and administrative	**20,512,998**	18,717,549
	$166,078,684	$148,110,176

13. Health Care Regulation

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government

13. Health Care Regulation (continued)

activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse and other statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that the System is in compliance with fraud and abuse regulations, as well as other applicable government laws and regulations. While no regulatory inquiries have been made which are expected to have a material adverse effect on the consolidated financial statements, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.