

**Floyd Memorial Hospital and Health Services  
A Component Unit of Floyd County, Indiana**

Accountants' Report and Financial Statements

December 31, 2007 and 2006



**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**  
December 31, 2007 and 2006

**Contents**

<b>Independent Accountants' Report.....</b>	<b>1</b>
<b>Management's Discussion and Analysis .....</b>	<b>2</b>
<b>Financial Statements</b>	
Balance Sheets.....	8
Floyd Memorial Foundation, Inc. – Statements of Financial Position .....	9
Statements of Revenues, Expenses and Changes in Net Assets .....	10
Floyd Memorial Foundation, Inc. – Statements of Activities.....	11
Statements of Cash Flows.....	12
Notes to Financial Statements .....	13



## Independent Accountants' Report

Board of Trustees  
Floyd Memorial Hospital and Health Services  
New Albany, Indiana

We have audited the accompanying balance sheets of Floyd Memorial Hospital and Health Services (Hospital), a component unit of Floyd County, Indiana, as of December 31, 2007 and 2006, and the related statements of revenues, expenses and 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 did not audit the financial statements of Floyd Memorial Foundation, Inc., which is discretely presented in the financial statements. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates the amounts included for Floyd Memorial Foundation, Inc., is based on the report of the other auditors.

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 the Hospital as of December 31, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

BKD, LLP

April 18, 2008

# **Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana**

## **Management's Discussion and Analysis Years Ended December 31, 2007 and 2006**

### ***Introduction***

This management's discussion and analysis of the financial performance of Floyd Memorial Hospital and Health Services (Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2007 and 2006. It should be read in conjunction with the accompanying financial statements of the Hospital.

### ***Financial Highlights***

- Cash and investments increased by \$13,393,998 or 32.28% in 2007 as compared to 2006
- The Hospital's net assets increased in the past year by \$3,204,295 or 3.0%
- The Hospital reported an operating gain in 2007 of \$6,491,371 or 4.2% of total operating revenues
- Net nonoperating revenues decreased by \$4,641,369 in 2007 as compared to 2006
- Days cash on hand increased from 110.9 in 2006 to 147.1 in 2007
- Debt service coverage ratio improved from 0.9 in 2006 to 3.4 in 2007

### ***Using This Annual Report***

The Hospital's financial statements consist of three statements—a balance sheet, a statement of revenues, expenses and changes in net assets and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital reports as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

### ***The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets***

The balance sheet and the statement of revenues, expenses and changes in net assets report information about the Hospital's resources and its activities for purposes of illustrating the effects of the past year's activity on the financial health of the institution. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. As the Hospital uses the accrual basis of accounting, current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Hospital's total net assets—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Management's Discussion and Analysis Years Ended December 31, 2007 and 2006

### ***The Statement of Cash Flows***

The statement of cash flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. The statement of cash flows illustrates the uses and sources of cash for the year.

### ***The Hospital's Net Assets***

The Hospital's net assets are the difference between assets and liabilities reported in the balance sheet. The Hospital's net assets increased by \$3,204,295 or 3% in 2007 over 2006, as shown in Table 1.

**Table 1: Assets, Liabilities and Net Assets**

	2007	2006
<b>Assets</b>		
Patient accounts receivable, net	\$ 21,968,959	\$ 21,834,628
Other current assets	27,345,922	16,298,608
Capital assets, net	130,771,270	133,544,336
Other noncurrent assets	56,261,994	58,518,614
Total assets	\$ 236,348,145	\$ 230,196,186
<b>Liabilities</b>		
Long-term debt	\$ 98,093,190	\$ 99,956,377
Other current and noncurrent liabilities	29,395,279	24,584,428
Total liabilities	127,488,469	124,540,805
<b>Net Assets</b>		
Invested in capital assets, net of related debt	38,060,772	41,368,751
Restricted expendable	10,089,432	13,884,551
Unrestricted	60,709,472	50,402,079
Total net assets	108,859,676	105,655,381
Total liabilities and net assets	\$ 236,348,145	\$ 230,196,186

A significant change in the Hospital's assets in 2007 is the increase in other current assets. This primarily consists of an increase in cash and cash equivalents in 2007 by \$11,962,730 (200%) as compared to 2006. The cash increase is attributable to improved operations highlighted by an increase in net patient service revenue of \$15,357,811 without a significant change in expenses in 2007 compared to 2006 and a reduction of days in accounts receivable in 2007 to 52 compared to 57.5 in 2006.

**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**  
**Management's Discussion and Analysis**  
**Years Ended December 31, 2007 and 2006**

***Operating Results and Changes in the Hospital's Net Assets***

In 2007, the Hospital's net assets increased by \$3,204,295 or 3%, as shown in Table 2. This increase is made up of several different components and represents a significant change when compared with the decrease in net assets for 2006 of \$7,422,780 or 6.6%.

**Table 2: Operating Results and Changes in Net Assets**

	<u>2007</u>	<u>2006</u>
Net patient service revenue	\$ 153,813,413	\$ 138,455,522
Other operating revenues	<u>2,624,446</u>	<u>2,424,100</u>
Total operating revenues	<u>156,437,859</u>	<u>140,879,622</u>
<b>Operating Expenses</b>		
Salaries and wages and employee benefits	75,678,994	77,560,864
Purchased services and professional fees	14,021,555	13,400,860
Depreciation and amortization	14,033,168	12,600,377
Other operating expenses	<u>46,212,771</u>	<u>46,108,986</u>
Total operating expenses	<u>149,946,488</u>	<u>149,671,087</u>
<b>Operating Income (Loss)</b>	<u>6,491,371</u>	<u>(8,791,465)</u>
<b>Nonoperating Revenues (Expenses)</b>		
Investment income	706,568	3,990,798
Noncapital grants and contributions	363,427	383,666
Interest expense	(4,283,495)	(2,694,901)
Other nonoperating revenues and expenses, net	<u>(101,326)</u>	<u>(353,020)</u>
Total nonoperating revenues (expenses)	<u>(3,314,826)</u>	<u>1,326,543</u>
<b>Capital Grants</b>	<u>27,750</u>	<u>42,142</u>
<b>Change in Net Assets</b>	<u>\$ 3,204,295</u>	<u>\$ (7,422,780)</u>

***Operating Income (Loss)***

The first component of the overall change in the Hospital's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services.

**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**  
**Management's Discussion and Analysis**  
**Years Ended December 31, 2007 and 2006**

The operating income for 2007 was \$6,491,371 as compared to an operating loss of \$8,791,465 for 2006. The primary components of change in operating results are:

- An increase in contractual allowances as a percent of gross revenues from 58.2% in 2006 to 60.5% in 2007
- An increase in net patient service revenue of \$15,357,891 or 11.09% without a significant change in operating expenses
- A decrease in salaries and benefits for the Hospital's employees of \$1,881,870 or 2.4%
- An increase in medical supply and drug costs of \$2,478,989 or 7.0%
- An increase in depreciation and amortization of \$1,432,791 or 11.4%

Net patient service revenue increased by 11.09% due to an increase in patient days of 8.6% from 2006 to 2007 and an 8.0% charge increase. The increase in revenue was also due to continued expansion of the Hospital's cardiovascular service line, including open-heart surgery in 2007. Revenues from most outpatient services increased by at least 5.0%, including cardiology, laboratory, imaging and home oxygen and medical equipment.

Full-time equivalent employees decreased from 1,409 in 2006 to 1,316 in 2007 or 6.6%. This was primarily due to the Hospital's diligent focus on productivity and proper staffing throughout the entire facility.

The rate of health care inflation has a direct effect on the cost of services provided by the Hospital. Expenditures for medical supplies and prescription drugs are a major component of the Hospital's costs. In 2006, supplies and prescription drug costs totaled \$35,280,648 or 23.57% of total operating expenses. In 2007, the costs totaled \$37,759,637 or 25.18% of total operating expenses, for an increase of \$2,478,989 or 7.02% over 2006. Some of the major factors contributing to the increased medical supply and drug costs include an aging population, an increase in the complexity of patient cases, an increase in cardiac procedures, the introduction of new drugs that cannot be obtained in generic form, changes in therapeutic mix and pharmaceutical marketing.

The Hospital also made significant progress in reducing cost per adjusted discharge between 2006 and 2007.

***Nonoperating Revenues and Expenses***

Nonoperating revenues and expenses consist primarily of investment income, interest expense, grants and contributions. Interest expense increased by \$1,588,594 from 2006 to 2007 due to the building program being placed into service in 2007. During the construction period, interest on such bonds was capitalized along with the cost of the project. From 2006 to 2007, there was a \$161,251 increase in gains from investments in affiliated companies. The Hospital experienced a loss of \$2,002,400 related to the fair market value of its swap agreements associated with the 2003 Bond Issues.

**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**  
**Management's Discussion and Analysis**  
**Years Ended December 31, 2007 and 2006**

***The Hospital's Cash Flows***

Changes in the Hospital's cash flows are consistent with changes in operating income and nonoperating revenues and expenses for 2007 and 2006.

***Capital Asset and Debt Administration***

***Capital Assets***

At the end of 2007, the Hospital had \$130,771,270 invested in capital assets, net of accumulated depreciation; this decrease of approximately \$3 million from 2006 is primarily due to a full year of depreciation taken on assets that became fully operational in 2006. In 2007, the Hospital purchased new equipment costing \$5,153,165. Included in these purchases are a PACS radiology system, a hospital-wide communication system and several digital mammogram units.

***Debt***

At December 31, 2007, the Hospital had \$101,536,276 in revenue bonds and capital lease obligations outstanding. No additional significant debt was incurred in 2007.

***Other Operating Factors***

***Indiana Medicaid Disproportionate Share Hospital (DSH) Payment Program***

The DSH program (which involves inter-governmental transfers with significant matching federal dollars) has experienced additional scrutiny from the Centers for Medicare and Medicaid Services (CMS, or commonly referred to as Medicare) and our nation's Congressional leaders, which creates challenges in estimating the level of expected payments from the Indiana Medicaid DSH program.

Payments under the Indiana Medicaid DSH program are typically made several years in arrears. At any given time, the Hospital could expect payments from the program for the previous two or three state fiscal years. As of the date of this report, partial payments have been made from the 2006 state fiscal year, but no payments have been made to the Hospital for the 2007 or 2008 state fiscal years.

In May 2007, CMS issued a final rule that may materially affect Indiana's ability to operate the DSH program. Congress issued a one-year moratorium on the final rule, which is scheduled to expire in May 2008. In connection with this final rule, the Indiana Medicaid DSH hospitals are working collaboratively with the Indiana Family and Social Services Administration (FSSA) to accelerate payments from the 2006, 2007 and 2008 state fiscal years before the moratorium expires in May 2008.

**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**  
**Management's Discussion and Analysis**  
**Years Ended December 31, 2007 and 2006**

As described above, the level of payments expected from the Indiana Medicaid DSH program is challenging. Management has recorded a reasonable estimate of the expected payments for the 2006 and 2007 state fiscal years as a year-end audit adjustment. However, if the Indiana Medicaid DSH hospitals are successful in negotiating with the FSSA, a material change in estimate could result in fiscal year 2008.

***Northgate Surgical Center LLC***

In January 2007, the Hospital entered into a joint venture with Northgate Surgical Center LLC, an outpatient surgery center. The purpose of this venture was to form an alliance with a respected hand surgery group, Kleinert and Kutz LLC, and to expand surgical services in the Southern Indiana area.

***Failed Bond Auction***

The Hospital issued Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 2003A (2003A Bonds) and 2003B (2003B Bonds) as auction-rate securities. The 2003A Bonds and 2003B Bonds use a bond insurer for credit enhancement and liquidity support. Under the terms of the bond indentures, if for any reason the 2003A Bonds and 2003B Bonds do not remarket on any given remarketing date, the interest rate defaults to a maximum rate as calculated under the trust indentures which is 150% of the AA rated commercial paper rate. On February 2, 2008, and March 18, 2008, the 2003A Bonds and 2003B Bonds, respectively, failed to remarket and defaulted to the rate noted above. The Hospital is currently under negotiations to provide an improved credit enhancement vehicle backing these bonds that would result in a much lower rate of interest.

***Contacting the Hospital's Financial Management***

This financial report is designed to provide our patients, suppliers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the chief financial officer by telephoning 812.948.7402.

**Floyd Memorial Hospital and Health Services  
A Component Unit of Floyd County, Indiana**

**Balance Sheets  
December 31, 2007 and 2006**

**Assets**

	<b>2007</b>	<b>2006</b>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 17,942,602	\$ 5,979,872
Restricted cash and investments - current	1,033,604	1,016,127
Patient accounts receivable, net of allowance; 2007 - \$13,151,644, 2006 - \$11,203,418	21,968,959	21,834,628
Estimated amounts due from third-party payers	2,247,063	4,430,596
Supplies	2,680,593	2,605,117
Prepaid expenses and other current assets	3,442,060	2,266,896
Total current assets	49,314,881	38,133,236
<b>Noncurrent Cash and Investments</b>		
Internally designated	36,940,039	35,508,771
Held by trustee for debt service	10,089,432	13,884,551
	47,029,471	49,393,322
Less amount required to meet current obligations	1,033,604	1,016,127
	45,995,867	48,377,195
<b>Capital Assets, Net</b>	130,771,270	133,544,336
<b>Other Assets</b>		
Other	10,266,127	10,141,419
Total assets	\$ 236,348,145	\$ 230,196,186

## Liabilities and Net Assets

	<u>2007</u>	<u>2006</u>
<b>Current Liabilities</b>		
Current maturities of long-term debt	\$ 1,928,662	\$ 1,787,670
Promissory note	-	2,380,000
Payable to suppliers and contractors	6,946,418	4,716,936
Payable to employees (including payroll taxes and benefits)	6,792,853	6,668,154
Accrued expenses	1,902,573	1,687,100
Due to Floyd Memorial Foundation	15,304	25,122
	<u>17,585,810</u>	<u>17,264,982</u>
<b>Fair Value of Interest Rate Swap Agreements</b>	5,062,166	3,059,766
<b>Long-term Debt</b>	98,093,190	99,956,377
<b>Accrued Pension and Other Long-term Liabilities</b>	<u>6,747,303</u>	<u>4,259,680</u>
<b>Total liabilities</b>	<u>127,488,469</u>	<u>124,540,805</u>
<b>Net Assets</b>		
Invested in capital assets, net of related debt	38,060,772	41,368,751
Restricted-expendable for		
Debt service	2,778,078	2,699,007
Capital acquisitions	7,311,354	11,185,544
Unrestricted	<u>60,709,472</u>	<u>50,402,079</u>
<b>Total net assets</b>	<u>108,859,676</u>	<u>105,655,381</u>
<b>Total liabilities and net assets</b>	<u>\$ 236,348,145</u>	<u>\$ 230,196,186</u>

**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**  
**Floyd Memorial Foundation, Inc.**

**Statements of Financial Position**  
**December 31, 2007 and 2006**

**Assets**

	2007	2006
<b>Current Assets</b>		
Cash and cash equivalents	\$ 369,468	\$ 366,095
Pledges receivable, current portion	44,637	67,313
Interest receivable	14,141	12,274
	428,246	445,682
<b>Assets Whose Use Is Limited</b>	3,875,272	3,262,389
<b>Property and Equipment, At Cost</b>		
Land	-	12,500
Building	-	67,500
Equipment	-	5,260
	-	85,260
Less accumulated depreciation	-	29,619
	-	55,641
<b>Other Assets</b>		
Pledges receivable, net of current portion	42,962	60,444
Cash surrender value of life insurance	76,958	95,959
	119,920	156,403
Total assets	\$ 4,423,438	\$ 3,920,115

**Liabilities and Net Assets**

<b>Current Liabilities</b>		
Grant payable	\$ -	\$ 30,000
Total current liabilities	-	30,000
<b>Net Assets</b>		
Unrestricted	3,814,488	3,468,961
Temporarily restricted	597,780	409,984
Permanantly restricted	11,170	11,170
Total net assets	4,423,438	3,890,115
Total liabilities and net assets	\$ 4,423,438	\$ 3,920,115

**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**  
**Statements of Revenues, Expenses and Changes in Net Assets**  
**Years Ended December 31, 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>Operating Revenues</b>		
Net patient service revenue, net of provision for uncollectible accounts	\$ 153,813,413	\$ 138,455,522
Other	2,624,446	2,424,100
Total operating revenues	156,437,859	140,879,622
<b>Expenses and Losses</b>		
Salaries and benefits	75,678,994	77,560,864
Purchased services and professional fees	14,021,555	13,400,860
Supplies	37,759,637	35,280,648
Other expenses	8,598,065	10,348,523
Depreciation and amortization	14,033,168	12,600,377
(Gain) loss on sale of property and equipment	(144,931)	479,815
Total operating expenses	149,946,488	149,671,087
<b>Operating Income (Loss)</b>	6,491,371	(8,791,465)
<b>Nonoperating Revenues (Expenses)</b>		
Investment income	706,568	3,990,798
Interest expense	(4,283,495)	(2,694,901)
Noncapital grants and contributions	363,427	383,666
Loss on investment in equity investee	(191,769)	(353,020)
Other	90,443	-
Total nonoperating revenues (expenses)	(3,314,826)	1,326,543
<b>Excess (Deficiency) of Revenues Over Expenses Before Capital Grants</b>	3,176,545	(7,464,922)
<b>Capital Grants</b>	27,750	42,142
<b>Increase (Decrease) in Net Assets</b>	3,204,295	(7,422,780)
<b>Net Assets, Beginning of Year</b>	105,655,381	113,078,161
<b>Net Assets, End of Year</b>	\$ 108,859,676	\$ 105,655,381

**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**  
**Floyd Memorial Foundation, Inc.**  
**Statements of Activities**  
**Years Ended December 31, 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>Unrestricted Revenues</b>		
Contributions	\$ 77,449	\$ 43,961
Gala	-	70,771
Investment income	347,907	344,073
Planned giving	803	5,358
Gain on sale of property	25,509	-
Net assets released from restrictions	128,391	299,541
Total unrestricted revenues	580,059	763,704
<b>Expenses</b>		
Grants	90,564	180,453
Fundraising - golf outing	94,763	85,108
Fundraising - other	545	70,003
General and administrative	48,660	44,602
Total expenses	234,532	380,166
<b>Change in Unrestricted Net Assets</b>	345,527	383,538
<b>Temporarily Restricted Net Assets</b>		
Contributions	22,205	32,258
Golf outing	293,982	304,574
Net assets released from restrictions	(128,391)	(299,541)
<b>Change in Temporarily Restricted Net Assets</b>	187,796	37,291
<b>Change in Net Assets</b>	\$ 533,323	\$ 420,829
<b>Unrestricted Net Assets</b>		
Beginning of the year	\$ 3,468,961	\$ 3,085,423
Change in net assets	345,527	383,538
End of year	\$ 3,814,488	\$ 3,468,961
<b>Temporarily Restricted Net Assets</b>		
Beginning of the year	\$ 409,984	\$ 372,693
Change in net assets	187,796	37,291
End of year	\$ 597,780	\$ 409,984
<b>Permanently Restricted Net Assets</b>		
Beginning of year	\$ 11,170	\$ 11,170
End of year	\$ 11,170	\$ 11,170

**Floyd Memorial Hospital and Health Services**  
**A Component Unit of Floyd County, Indiana**

**Statements of Cash Flows**  
**Years Ended December 31, 2007 and 2006**

	2007	2006
<b>Operating Activities</b>		
Receipts from and on behalf of patients	\$ 155,862,615	\$ 140,907,812
Payments to suppliers and contractors	(59,177,798)	(64,429,419)
Payments to employees	(73,280,650)	(75,048,378)
Other receipts, net	2,624,446	2,424,100
Net cash provided by operating activities	26,028,613	3,854,115
<b>Noncapital Financing Activities</b>		
Noncapital grants and contributions	453,870	383,666
Net cash provided by noncapital financing activities	453,870	383,666
<b>Capital and Related Financing Activities</b>		
Capital grants and contributions	27,750	42,142
Interest payments on long-term obligations	(4,214,035)	(2,489,281)
Principal paid on long-term debt and capital leases	(1,824,873)	(2,461,998)
Purchase of capital assets	(11,132,697)	(15,113,838)
Proceeds from issuance of long-term debt	-	15,000,000
Principal paid on promissory note	(2,380,000)	-
Payment of deferred financing costs	-	(312,641)
Net cash used in capital and related financing activities	(19,523,855)	(5,335,616)
<b>Investing Activities</b>		
Proceeds from disposition of investments	9,392,704	76,535,306
Purchase of investments	(6,028,473)	(73,055,396)
Interest and dividends on investments	1,708,588	1,522,474
Investment in equity investees	(191,769)	(500,000)
Distributions to equity investees	(55,200)	600,000
Proceeds from sale of assets	178,252	20,700
Net cash provided by investing activities	5,004,102	5,123,084
<b>Increase in Cash and Cash Equivalents</b>	11,962,730	4,025,249
<b>Cash and Cash Equivalents, Beginning of Year</b>	5,979,872	1,954,623
<b>Cash and Cash Equivalents, End of Year</b>	\$ 17,942,602	\$ 5,979,872

	<u>2007</u>	<u>2006</u>
<b>Reconciliation of Net Operating Revenues (Expenses) to</b>		
<b>Net Cash Provided by Operating Activities</b>		
Operating income (loss)	\$ 6,491,371	\$ (8,791,465)
Depreciation and amortization	14,033,188	12,600,377
Provision for uncollectible accounts	14,169,566	17,136,818
(Gain) loss on disposition of assets	(144,931)	479,815
Changes in operating assets and liabilities		
Patient accounts receivable	(14,303,897)	(13,156,199)
Estimated amounts due from and to third-party payers	2,183,533	(1,528,329)
Accounts payable and accrued expenses	5,064,401	(1,374,196)
Prepaid assets, supplies and other assets	(1,464,618)	(1,512,706)
	<u>\$ 26,028,613</u>	<u>\$ 3,854,115</u>
 <b>Supplemental Cash Flows Information</b>		
Property, plant and equipment additions in accounts payable	\$ 2,090,451	\$ -
Capital lease obligations incurred for capital assets	\$ -	\$ 2,023,127
Promissory note incurred for investment in equity investee	\$ -	\$ 2,380,000

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements

December 31, 2007 and 2006

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

#### ***Nature of Operations and Reporting Entity***

Floyd Memorial Hospital and Health Services (Hospital) is an acute-care hospital located in New Albany, Indiana. The Hospital is a component unit of Floyd County (County) and the Board of County Commissioners appoints members to the board of trustees of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Floyd County area.

#### ***Basis of Accounting and Presentation***

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally federal and state grants and county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific (such as county appropriations), investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued on or after November 30, 1989, and do not conflict with or contradict GASB pronouncements.

#### ***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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### ***Cash Equivalents***

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2007 and 2006, cash equivalents consisted primarily of repurchase agreements.

### ***Risk Management***

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

The Hospital is self insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured portion of employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

### ***Investments and Investment Income***

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition. The investment in equity investee is reported on the equity method of accounting. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income includes dividend and interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value.

### ***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 uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

### ***Supplies***

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

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements

December 31, 2007 and 2006

### Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method 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. The following estimated useful lives are being used by the Hospital:

Land improvements	2 - 25 years
Buildings and leasehold improvements	5 - 40 years
Equipment	2 - 20 years

The Hospital capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. Total interest capitalized and incurred at December 31 was:

	2007	2006
Total interest expense incurred on borrowings for project	\$ 443,095	\$ 1,537,598
Interest income from investment of proceeds of borrowings for project	399,290	56,593
Net interest cost capitalized	\$ 43,805	\$ 1,481,005
Interest capitalized	\$ 43,805	\$ 1,481,005
Interest charged to expense	4,283,495	2,694,901
Total interest incurred	\$ 4,327,300	\$ 4,175,906

### Other Assets

*Split-dollar Life Insurance Policies.* Other assets include the cumulative paid premiums under a split-dollar life insurance policy for certain employees of the Hospital. In accordance with the policy agreement, the Hospital will receive the greater of the cash surrender value of the policy or cumulative premiums upon termination of the contract by the employees or their death.

*Investment in Joint Ventures.* The investment in joint ventures is accounted for by the equity method of accounting and is further described in Note 5.

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

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements

December 31, 2007 and 2006

### **Other Long-term Liabilities**

Other long-term liabilities consist of a deferred compensation agreement with a former employee. The agreement is to be funded with proceeds from operations. No additional benefits are being accrued under the agreement.

### **Interest Rate Swap Agreements**

The Hospital uses interest rate swap agreements to manage financial risks related to interest rate movements and the effects on its cash flows. The Hospital has not designated the interest rate swap agreement as a hedging instrument under the provision of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. As a result, the agreement is recorded at its fair value in the balance sheet. The net cash payments or receipts under the interest rate swap agreements are recorded as an increase or decrease to interest expense. Changes in fair value of the interest rate swap agreements are included in investment income in the accompanying statement of revenues, expenses and changes in net assets.

### **Compensated Absences**

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

### **Net Assets**

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

# **Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana**

## **Notes to Financial Statements December 31, 2007 and 2006**

### ***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 and includes estimated retro-active revenue adjustments and a provision for uncollectible accounts. Retro-active adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

### ***Charity Care***

The Hospital provides charity care to patients who are unable to pay for services. The amount of charity care is included in net patient service revenue and is not separately classified from the provision for uncollectible accounts.

### ***Income Taxes***

As an essential government function of the county, the Hospital is generally exempt from federal and state income taxes under Section 115 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.

### ***Floyd Memorial Foundation***

Floyd Memorial Foundation (Foundation) is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs. The board of the Foundation is self-perpetuating.

Although the Hospital does not control the timing or amount of receipts from the Foundation, the majority of the Foundation's resources and related income are restricted by donors for the benefit of the Hospital. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the Hospital, the Foundation is considered a component unit of the Hospital and is discretely presented in the Hospital's financial statements.

During the years ended December 31, 2007 and 2006, the Foundation provided \$85,375 and \$172,600, respectively, of support to the Hospital. Complete financial statements of the Foundation may be obtained from its administrative office at the following address: 1850 State Street, New Albany, Indiana.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

The Foundation is a private nonprofit organization that reports under FASB standards, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation's statements in the Hospital's financial reporting entity for these differences.

### **Reclassifications**

Certain reclassifications have been made to the 2006 financial statements to conform to the 2007 presentation. The reclassifications had no effect on the changes 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 rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

**Medicaid.** Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed at a prospectively determined rate per discharge for inpatient services and per visit for outpatient services.

The Hospital qualifies as a Medicaid disproportionate share hospital (DSH) provider under Indiana Law (HEA 1095, Public Law 27-1992) and, as such, is eligible to receive DSH payments. The amounts of these additional DSH funds are dependent on regulatory approval by agencies of the federal and state governments and is determined by level, extent and cost of uncompensated care (as defined) and various other factors. DSH payments have been made by the state of Indiana and the Hospital records such amounts as revenue when reasonably determined that the funds will be received. The Hospital recognized \$3,824,083 and \$5,102,307 of net patient service revenue related to the DSH program for the years ended December 31, 2007 and 2006, respectively. The Hospital recognized receivables from this program in the amount of \$2,042,842 and \$4,311,540 at December 31, 2007 and 2006, respectively, for various Indiana state fiscal years, which ends June 30 each year. The 2007 net patient service revenue decreased by approximately \$1,500,000 due to a change in estimate related to calculation of the DSH program receivable. It is possible these estimates could change materially in the near term.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements

December 31, 2007 and 2006

In May of 2007, the Centers for Medicare and Medicaid issued a final ruling that may change the state of Indiana's ability to operate the DSH program as described above. Upon enactment of this final ruling, Congress issued a one year moratorium on the ruling, which is scheduled to expire in May 2008. It is unknown if the moratorium will be extended or the financial implications to the DSH program in the event the moratorium is not extended.

Effective January 1, 2008, the State of Indiana began operating an insurance plan for the benefit of Indiana residents without health insurance. The plan, referred to as the Healthy Indiana Plan (HIP), will be funded through an additional state cigarette tax and with the use of a portion of the DSH funds described above. As such, the level of future DSH payments may also be negatively affected.

Approximately 44% and 46% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2007 and 2006, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

### **Note 3: Deposits, Investments and Investment Income**

#### ***Deposits***

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of state law.

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation (FDIC) or by the Indiana Public Deposit Insurance Fund (IPDIF). This includes any deposit accounts issued or offered by a qualifying financial institution. Accordingly, all deposits in excess of FDIC levels are covered by the IPDIF and considered collateralized.

#### ***Investments***

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest to a limited extent in corporate bonds and equity securities.

**Floyd Memorial Hospital and Health Services  
A Component Unit of Floyd County, Indiana**

**Notes to Financial Statements  
December 31, 2007 and 2006**

At December 31, 2007, the Hospital had the following investments and maturities:

Type	Fair Value	Maturities in Years			
		Less Than 1	1 to 5	6 to 10	More Than 10
Repurchase agreements	\$ 14,693,000	\$ 14,693,000	\$ -	\$ -	\$ -
U.S. Treasury obligations	11,417,056	2,613,587	8,803,469	-	-
U.S. agencies obligations	2,311,331	871,781	1,336,836	-	102,714
Mutual funds	21,721,967	21,721,967	-	-	-
Money market mutual funds	11,400,491	11,400,491	-	-	-
	<u>\$ 61,543,845</u>	<u>\$ 51,300,826</u>	<u>\$10,140,305</u>	<u>\$ -</u>	<u>\$ 102,714</u>

**Interest Rate Risk** – Interest rate risk is the risk of fair value losses arising from rising interest rates. The Hospital does not have a formal policy to limit its interest rate risk. The money market mutual funds are presented as an investment with a maturity of less than one year because they are redeemable in full immediately.

**Credit Risk** – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in corporate bonds to the top two ratings issued by nationally recognized statistical rating organizations (NRSROs). At December 31, 2007, the Hospital's investments in U.S. agencies obligations not directly guaranteed by the U.S. Government were rated Aaa by Moody's Investor Services.

**Custodial Credit Risk** – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the underlying securities for the Hospital's investments in repurchase agreements at December 31, 2007, are held by the counterparties in other than the Hospital's name. The Hospital's investment policy does not address how securities underlying repurchase agreements are to be held.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### **Summary of Carrying Values**

The carrying values of deposits and investments shown above are included in the balance sheets at December 31 were as follows:

	<b>2007</b>	<b>2006</b>
Carrying value		
Deposits	\$ 3,428,228	\$ 1,818,872
Investments	61,543,845	53,554,322
	\$ 64,972,073	\$ 55,373,194

Included in the following balance sheet captions:

	<b>2007</b>	<b>2006</b>
Cash and cash equivalents	\$ 17,942,602	\$ 5,979,872
Restricted cash and investments - current	1,033,604	1,016,127
Noncurrent cash and investments	45,995,867	48,377,195
	\$ 64,972,073	\$ 55,373,194

### **Investment Income**

Investment income for the years ended December 31 consisted of:

	<b>2007</b>	<b>2006</b>
Interest and dividend income	\$ 1,708,588	\$ 1,522,474
Net increase in fair value of investments	1,000,380	924,889
Change in fair value of interest rate swap agreements	(2,002,400)	1,543,435
	\$ 706,568	\$ 3,990,798

The Hospital has entered into certain interest rate swap agreements associated with the 2003A and 2003B Bonds (see Note 12 for related disclosures).

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31 consisted of:

	2007	2006
Medicare	\$ 9,039,567	\$ 6,188,631
Medicaid	2,623,867	2,566,826
Other third-party payers	10,518,078	11,787,682
Patients	12,939,091	12,494,907
	35,120,603	33,038,046
Less allowance for uncollectible accounts	13,151,644	11,203,418
	\$ 21,968,959	\$ 21,834,628

### Note 5: Investments in Uncombined Entities

The investments in uncombined entities are accounted for on the equity method. The equity earnings of the uncombined entities are accounted for on the equity method and are included in nonoperating revenues. Investments in uncombined entities consist of a 33.33% interest in Southern Indiana Rehabilitation Hospital (an acute rehabilitation hospital), a 48% interest in Kleinert, Kutz Associates Surgery Center, LLC, d/b/a Northgate Surgery Center, LLC (an outpatient surgery center), an 11% interest in Indiana Health-Care Reciprocal Risk Retention Group (a medical malpractice insurance captive), a 50% interest in Southern Indiana Health Care Alliance, LLC (an organization that furthers the charitable and health care mission of its members), a 50% interest in Harrison-Floyd Health Services, LLC (an outpatient center providing urgent treatment services and occupational medicine) and a 50% interest in Northgate Medical Imaging, LLC, d/b/a Priority Imaging (an outpatient diagnostic imaging center).

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### Note 6: Capital Assets

Capital assets activity for the years ended December 31 were:

	2007				Ending Balance
	Beginning Balance	Additions	Disposals	Transfers	
Land	\$ 7,820,099	\$ -	\$ -	\$ -	\$ 7,820,099
Land improvements	4,127,807	68,357	(772,004)	-	3,424,160
Buildings and leasehold improvements	123,998,727	248,708	(5,250,947)	279,252	119,275,740
Equipment	122,331,768	5,153,165	(17,082,549)	-	110,402,384
Construction in progress	547,539	5,683,203	-	(279,252)	5,951,490
	<u>258,825,940</u>	<u>11,153,433</u>	<u>(23,105,500)</u>	<u>-</u>	<u>246,873,873</u>
Less accumulated depreciation					
Land improvements	3,113,785	138,953	(772,005)	-	2,480,733
Buildings and leasehold improvements	38,936,559	3,602,465	(5,250,948)	-	37,288,076
Equipment	83,231,260	10,131,024	(17,028,490)	-	76,333,794
Total accumulated depreciation	<u>125,281,604</u>	<u>13,872,442</u>	<u>(23,051,443)</u>	<u>-</u>	<u>116,102,603</u>
Capital assets, net	<u>\$ 133,544,336</u>	<u>\$ (2,719,009)</u>	<u>\$ (54,057)</u>	<u>\$ -</u>	<u>\$ 130,771,270</u>

  

	2006				Ending Balance
	Beginning Balance	Additions	Disposals	Transfers	
Land	\$ 6,741,704	\$ 1,094,895	\$ (16,500)	\$ -	\$ 7,820,099
Land improvements	3,563,359	564,448	-	-	4,127,807
Buildings and leasehold improvements	58,965,284	105,071	-	64,928,372	123,998,727
Equipment	115,684,206	7,885,721	(1,592,292)	354,133	122,331,768
Construction in progress	58,343,214	7,486,830	-	(65,282,505)	547,539
	<u>243,297,767</u>	<u>17,136,965</u>	<u>(1,608,792)</u>	<u>-</u>	<u>258,825,940</u>

**Floyd Memorial Hospital and Health Services  
A Component Unit of Floyd County, Indiana**

**Notes to Financial Statements  
December 31, 2007 and 2006**

	2006				Ending Balance
	Beginning Balance	Additions	Disposals	Transfers	
Less accumulated depreciation					
Land improvements	\$ 2,983,906	\$ 129,879	\$ -	\$ -	\$ 3,113,785
Buildings and leasehold improvements	35,937,520	2,999,039	-	-	38,936,559
Equipment	75,018,817	9,320,720	(1,108,277)	-	83,231,260
Total accumulated depreciation	<u>113,940,243</u>	<u>12,449,638</u>	<u>(1,108,277)</u>	<u>-</u>	<u>125,281,604</u>
Capital assets, net	<u>\$ 129,357,524</u>	<u>\$ 4,687,327</u>	<u>\$ (500,515)</u>	<u>\$ -</u>	<u>\$ 133,544,336</u>

**Note 7: Medical Malpractice Claims**

The Hospital purchases medical malpractice insurance from Indiana Healthcare Reciprocal Risk Retention Group (Risk Retention Group) under a claims-made policy. The Hospital pays an annual premium to Risk Retention Group for its torts insurance coverage. The Risk Retention Group's governing agreement specifies that the Risk Retention Group will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of stop-loss amounts. 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 claims experience, no liabilities were recorded at December 31, 2007 and 2006. It is possible that this estimate could change materially in the near term.

Prior to January 1, 2006, the Hospital was insured for medical malpractice claims through a claims-made policy with The Reciprocal of America (ROA), formally the Virginia Insurance Reciprocal. As a result of ROA going into receivership, the Hospital has effectively become self insured for claims prior to this date. As of December 31, 2007 and 2006, the Hospital accrued a liability of \$85,000 and \$189,500, respectively, relating to these claims. It is possible that this estimate could change materially in the near term.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements

December 31, 2007 and 2006

### Note 8: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of \$90,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during the years ended December 31 is summarized as follows:

	2007	2006
Balance, beginning of year	\$ 874,976	\$ 601,128
Current year claims incurred and changes in estimates for claims incurred in prior years	5,564,623	6,613,237
Claims and expenses paid	(5,626,209)	(6,339,389)
Balance, end of year	\$ 813,390	\$ 874,976

### Note 9: Promissory Note

In 2006, the Hospital entered into a promissory note with Kleinert, Kutz and Associates Hand Care Center, PLLC in connection with the purchase of 48% of the interest in Kleinert, Kutz and Associates Surgery Center, LLC. The note is a noninterest bearing promissory note in the amount of \$2,380,000 due on January 16, 2007. The note was paid in full by the Hospital in January 2007.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### Note 10: Long-term Obligations

The following is a summary of long-term debt transactions for the Hospital for the years ended December 31:

	2007				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds Payable - Series 1998	\$ 16,780,000	\$ -	\$ 700,000	\$ 16,080,000	\$ 735,000
Revenue Bonds Payable - Series 2003	69,800,000	-	750,000	69,050,000	700,000
Revenue Bonds Payable - Series 2006	15,000,000	-		15,000,000	100,000
Capital lease obligations	1,781,149	-	374,873	1,406,276	393,662
	103,361,149	-	1,824,873	101,536,276	1,928,662
Less					
Unamortized bond discount	245,870	-	16,256	229,614	-
Deferred amount on refunding	1,371,212	-	86,402	1,284,810	-
Total long-term debt obligations	<u>\$ 101,744,067</u>	<u>\$ -</u>	<u>\$ 1,722,215</u>	<u>\$ 100,021,852</u>	<u>\$ 1,928,662</u>

	2006				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds Payable - Series 1998	\$ 17,450,000	\$ -	\$ 670,000	\$ 16,780,000	\$ 700,000
Revenue Bonds Payable - Series 2003	71,350,000	-	1,550,000	69,800,000	750,000
Revenue Bonds Payable - Series 2006	-	15,000,000	-	15,000,000	-
Capital lease obligations	-	2,023,127	241,998	1,781,129	337,670
	88,800,000	17,023,127	2,461,998	103,361,129	1,787,670

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

	2006				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Less					
Unamortized bond discount	\$ 262,126	\$ -	\$ 16,256	\$ 245,870	\$ -
Deferred amount on refunding	1,457,615	-	86,403	1,371,212	-
Total long-term debt obligations	<u>\$ 87,080,259</u>	<u>\$ 17,023,127</u>	<u>\$ 2,359,339</u>	<u>\$ 101,744,047</u>	<u>\$ 1,787,670</u>

The following is a summary of other long-term obligations for the Hospital for the years ended December 31:

	2007				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Accrued pension liabilities	\$ 4,220,434	\$ 2,493,247	\$ 582,379	\$ 6,131,302	\$ -
Other long-term liabilities	39,246	827,762	-	867,008	251,007
Total other long-term obligations	<u>\$ 4,259,680</u>	<u>\$ 3,321,009</u>	<u>\$ 582,379</u>	<u>\$ 6,998,310</u>	<u>\$ 251,007</u>

	2006				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Accrued pension liabilities	\$ 2,532,154	\$ 2,037,693	\$ 349,413	\$ 4,220,434	\$ -
Other long-term liabilities	-	39,246	-	39,246	-
Total other long-term obligations	<u>\$ 2,532,154</u>	<u>\$ 2,076,939</u>	<u>\$ 349,413</u>	<u>\$ 4,259,680</u>	<u>\$ -</u>

### **Revenue Bonds Payable**

The Hospital has revenue bonds payable with the Indiana Healthcare Facility Financing Authority (Authority). The Master Trust Indenture requires that certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service in the balance sheets. The Master Trust Indenture also places limits on the incurrence of additional borrowings and requires that certain measures of financial performance be maintained so long as the bonds are outstanding. At December 31, 2007, the Hospital was in compliance with such requirements.

# **Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana**

## **Notes to Financial Statements December 31, 2007 and 2006**

### ***Series 1998***

In March 1998, the Hospital participated in the issuance of \$21,150,000 Indiana Health Facility Financing Authority Hospital Revenue Refunding Bonds, Series 1998 Bonds (1998 Bonds), which bears interest at rates ranging from 4.5% to 5.4%. The proceeds were used for the advanced refunding of the Authority's Series 1992 Bonds. The 1998 Bonds are subject to retirement in varying principle amounts through 2022. The bonds are secured by the gross revenues of the Hospital and the assets restricted under the bond indenture agreement.

### ***Series 2003***

In December 2003, the Hospital participated in the issuance of \$72,925,000 Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 2003A (2003A Bonds) and 2003B (2003B Bonds). The 2003A Bonds and 2003B Bonds, which were issued as Auction Rate Securities, bear interest at the auction rate, as determined by the results of an auction every 35 days under an agreement with The Bank of New York. The interest rates for these bonds were 4.9% and 4.5% at December 31, 2007, respectively. The proceeds were used for the advance refunding of the Authority's Series 1997 and Series 2000 Bonds and to finance certain capital projects. The 2003A Bonds and 2003B Bonds are subject to retirement in varying principal payments through 2034. The bonds are secured by the gross revenues of the Hospital. Payments of bond principle are also secured by an insurance policy issued by a commercial insurer.

### ***Series 2006***

In December 2006, the Hospital participated in the issuance of \$15,000,000 Indiana Health and Educational Facility Financing Authority Adjustable Rate Hospital Revenue Bonds, Series 2006 (2006 Bonds). The 2006 Bonds were issued as Auction Rate Securities, and bear interest at the auction rate, as determined by the results of weekly auctions under an agreement with Piper Jaffray & Co., 3.8% at December 31, 2007. The proceeds were used to finance certain capital projects. The 2006 Bonds are subject to retirement in varying principal payments through 2036. The bonds are secured by the gross revenues of the Hospital. Payments of bond principal and interest are also secured by a letter of credit in the amount of \$15,187,500 expiring on December 16, 2011, issued by a financial institution.

### ***Capital Lease Obligations***

The Hospital is obligated under leases for certain medical equipment that are accounted for as capital leases. The lease agreements bear interest at various amounts up to 8.78%. Assets under capital leases at December 31, 2007, totaled \$2,023,127, net of accumulated depreciation of \$606,938.

**Floyd Memorial Hospital and Health Services  
A Component Unit of Floyd County, Indiana**

**Notes to Financial Statements  
December 31, 2007 and 2006**

The debt service requirements for long-term obligations as of December 31, 2007, were as follows:

Years Ending December 31	Total to be Paid	Principal	Interest
2008	\$ 6,619,648	\$ 1,928,662	\$ 4,690,986
2009	6,870,938	2,289,660	4,581,278
2010	6,973,931	2,513,122	4,460,809
2011	6,766,866	2,324,832	4,442,034
2012 - 2017	38,835,068	15,280,000	23,555,068
2018 - 2023	38,540,268	20,120,000	18,420,268
2024 - 2029	37,816,950	26,025,000	11,791,950
2030 - 2036	34,888,309	31,055,000	3,833,309
	<u>\$177,311,978</u>	<u>\$101,536,276</u>	<u>\$ 75,775,702</u>

**Note 11: Line of Credit**

The Hospital has an unsecured open-ended demand line of credit in the amount of \$5,000,000 with a bank. At the Hospital's option, amounts outstanding under the line of credit bear interest at the bank's prime rate less 0.50% or the London Interbank Offering Rate (LIBOR), plus 1.25%. There were no borrowings on the line of credit at December 31, 2007 and 2006.

**Note 12: Interest Rate Swap Agreements**

***Objective of the Interest Rate Swap Agreements***

The Hospital's asset/liability strategy is to have a mixture of fixed- and variable-rate debt to take advantage of market fluctuations. As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations and to lower its borrowing costs when compared against fixed-rate debt at the time of issuance, the Hospital entered into interest rate swap agreements in connection with its 2003A and 2003B Bonds. The intention of the swap agreements is to effectively change the Hospital's variable interest rate on the 2003A and 2003B Bonds to a synthetic fixed rate of 4.05%.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### **Terms**

Under the interest rate swap agreements associated with each of the 2003A Bonds and 2003B Bonds, the Hospital receives interest from the counterparty at 70.00% of the one-month LIBOR and pays interest to the counterparty at a fixed rate of 4.05% on notional amounts totaling \$67,600,000 at December 31, 2007 and 2006. The interest rate swap agreements may be terminated by the Hospital upon five days written notice to the counterparty. The agreements were entered into on November 10, 2003, and are scheduled to expire on March 1, 2034, and required no initial net cash receipt or payment by the Hospital. Beginning in 2009, the notional amount of the swap agreements decline by a corresponding amount each time a principal payment becomes due on the associated debt until the notional amounts for each agreement reach \$2,650,000 at the termination of the swap agreements. Under the agreements, the Hospital pays or receives the net interest amount monthly, with the settlements included in interest expense.

### **Fair Value**

As of December 31, 2007 and 2006, the agreements had fair values of \$(5,062,166) and \$(3,059,766), respectively. The fair value of the agreement is recognized in the Hospital's balance sheets in long-term liabilities.

### **Interest Rate Risk**

As a means of limiting its exposure to fair value losses arising from rising variable interest rates associated with the interest rate swap agreements. Beginning in 2009, the notional amount of the swap agreements declines by a corresponding amount each time a principal payment becomes due on the associated debt until the notional amounts for each agreement reach \$2,650,000 at the termination of the swap agreements. The termination date of the swap agreements corresponds to the maturity of the 2003A Bonds and 2003B Bonds. At December 31, 2007, the notional amount of the interest rate swap agreements will decline as follows:

<b>Maturities in Years</b>			
<b>Less Than 1</b>	<b>1-5</b>	<b>6-10</b>	<b>More Than 10</b>
\$ -	\$ 5,500,000	\$ 6,625,000	\$ 55,475,000

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### **Credit Risk**

The swap's fair value represented the Hospital's credit exposure to the counterparty should the counterparty to this transaction fail to perform according to the terms of the swap agreement, the Hospital has a maximum possible loss equivalent to the swap's fair value at that date. As of December 31, 2007, the Hospital was not exposed to credit risk because the swap had a negative fair value. The swap counterparty was rated AA- by Fitch Ratings, A+ by Standard & Poor's and Aa3 by Moody's Investors Service as of December 31, 2007. The interest rate swap agreements do not contain collateral provisions for either party.

### **Basis Risk**

The swap exposes the Hospital to basis risk should the relationship between LIBOR and the auction rate set by the Hospital's remarketing agent change in a manner adverse to the Hospital. If an adverse change occurs in the relationship between these rates, the expected cost savings may not be realized.

### **Termination Risk**

The Hospital or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If the swap is terminated, the variable-rate notes would no longer have a synthetic fixed rate of interest. Also, if the swap has a negative fair value at the time of termination, the Hospital would be liable to the counterparty for a payment equal to the swap's fair value.

### **Note 13: Operating Leases**

The Hospital has entered into various operating leases for office space and medical equipment expiring at various years through 2016. Rent expense was approximately \$1,908,950 and \$1,757,000 for the years ended December 31, 2007 and 2006.

Future minimum lease payments at December 31, 2007, are:

2008	\$ 1,351,916
2009	923,040
2010	791,357
2011	685,064
2012	1,185,663
2013 – 2017	<u>2,484,270</u>
Future minimum lease payments	<u>\$ 7,421,310</u>

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### Note 14: Defined Benefit Pension Plan

#### *Plan Description*

The Hospital's defined benefit pension plan is a single-employer defined benefit pension plan administered by the plan's board of trustees who are appointed by the County Commissioners of Floyd County, Indiana. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The authority to establish and amend benefit provisions is set forth in Indiana Code 16-22-3-11. The plan issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing to the investment manager at Renaissance Investment Management, Inc., 1700 Young Street, Cincinnati, OH 45210-1521 or by calling 513.723.4500.

#### *Funding Policy*

The authority to establish and amend obligations of plan members is established by the written agreement between the Hospital's board of trustees and the plan administrator. Plan members are required to contribute 0% of their annual covered salary. The Hospital is required to contribute at an actuarially determined rate; the current rate is 0% of annual covered payroll.

#### *Annual Pension Cost and Net Pension Obligation*

The Hospital's annual pension cost and net pension obligation to the plan for December 31 were as follows:

	<b>2007</b>	<b>2006</b>
Annual required contribution	\$ 2,155,612	\$ 1,835,121
Interest on net pension obligation	337,635	202,572
Adjustment to annual required contribution	(582,379)	(349,413)
Annual pension cost	1,910,868	1,688,280
Contributions made	-	-
Increase in net pension obligation	1,910,868	1,688,280
Net pension obligation at beginning of the year	4,220,434	2,532,154
Net pension obligation at end of the year	\$ 6,131,302	\$ 4,220,434

The annual required contribution for 2007 was determined as part of an actuarial valuation on May 1, 2006, using the projected unit credit actuarial cost method. The actuarial assumptions included (a) 8% investment rate of return (net of administrative expenses) and (b) 4% projected salary increases per year. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a 10-year period.

**Floyd Memorial Hospital and Health Services  
A Component Unit of Floyd County, Indiana**

**Notes to Financial Statements  
December 31, 2007 and 2006**

**Three-year Trend Information**

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2005	\$ 1,301,840	0%	\$ 2,532,154
December 31, 2006	\$ 1,688,280	0%	\$ 4,220,434
December 31, 2007	\$ 1,910,868	0%	\$ 6,131,302

**Required Supplementary Information**

Schedule of Funding Progress for Defined Employee Pension Plan consisted of the following:

(Dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets a	Actuarial Accrued Liability (AAL) - Entry Age b	Unfunded AAL (UAAL) b-a	Funded Ratio a/b	Covered Payroll c	UAAL as a Percentage of Covered Payroll (b-a)/c
December 31, 2004	\$32,670	\$30,440	(\$2,230)	107%	\$35,876	(6%)
December 31, 2005	\$34,337	\$35,514	\$1,177	97%	\$40,412	3%
December 31, 2006	\$36,464	\$33,161	(\$3,303)	110%	\$45,555	(7%)

**Note 15: Defined Contribution Pension Plan**

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by a board of trustees appointed by the County Commissioners of Floyd County, Indiana. The plan provides retirement benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Contributions made by plan members at December 31, 2007 and 2006, were \$3,011,150 and \$2,895,507, or 5% of total payroll for both years. Contributions made by the Hospital at December 31, 2007 and 2006, were \$833,143 and \$1,042,743, or 1% and 2% of total payroll, respectively.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### **Note 16: Disclosures About Fair Value of Financial Instruments**

The following methods were used to estimate the fair value of financial instruments.

The fair values of certain of these instruments were calculated by discounting expected cash flows, which method involves significant judgments by management and uncertainties. Fair value is the estimated amount at which financial assets or liabilities could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Because no market exists for certain of these financial instruments and because management does not intend to sell these financial instruments, the Hospital does not know whether the fair values shown below represent values at which the respective financial instruments could be sold individually or in the aggregate.

#### ***Investments***

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Investments in real estate are excluded from the disclosure because they are not financial instruments.

#### ***Promissory Note***

Fair value is estimated based on the borrowing rates currently available to the Hospital for notes with similar terms and maturities.

#### ***Long-term Debt***

Fair value is estimated based on the borrowing rates currently available to the Hospital for debt with similar terms and maturities.

#### ***Interest Rate Swap Agreements***

The fair value has been estimated by a third party.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

The following table presents estimated fair values of the Hospital's financial instruments at December 31:

	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets</b>				
Cash and cash equivalents	\$ 17,942,602	\$ 17,942,602	\$ 5,979,872	\$ 5,979,872
Investments	47,029,471	47,029,471	49,393,322	49,393,322
	<u>\$ 64,972,073</u>	<u>\$ 64,972,073</u>	<u>\$ 55,373,194</u>	<u>\$ 55,373,194</u>
<b>Financial liabilities</b>				
Promissory note	\$ -	\$ -	\$ 2,380,000	\$ 2,380,000
Long-term debt	101,306,662	101,600,601	103,115,259	103,750,017
Interest rate swap agreements	5,062,166	5,062,166	3,059,766	3,059,766
	<u>\$ 106,368,828</u>	<u>\$ 106,662,767</u>	<u>\$ 108,555,025</u>	<u>\$ 109,189,783</u>

### **Note 17: 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 Notes 1 and 7.

#### ***Incurred, But Not Reported, Employee Health Insurance Claims***

Estimates of incurred, but not reported, health insurance claims are described in Note 8.

# Floyd Memorial Hospital and Health Services A Component Unit of Floyd County, Indiana

## Notes to Financial Statements December 31, 2007 and 2006

### ***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 self-insurance program (discussed elsewhere in these notes) or by 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. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

### ***Guarantee***

The Hospital guarantees certain third-party capital leases of an unconsolidated affiliated organization. The guarantee terms are through the duration of the capital leases which expire through 2012. At December 31, 2007 and 2006, the Hospital has guaranteed 50% of the \$4,877,530 and \$6,021,250 outstanding capital leases of the affiliated organization.

## **Note 18: Floyd Memorial Foundation**

### ***Financial Statements***

The financial statements of the Foundation are presented in accordance with the provisions of Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made* and No. 117, *Financial Statements of Not-for-Profit Organizations*. Statement No. 116 requires the Foundation to distinguish between contributions that increase permanently restricted net assets, temporarily restricted net assets and unrestricted net assets. It also required recognition of contributions, including contributed services meeting certain criteria, at fair values. Statement No. 117 establishes standards for external financial statements of not-for-profit organizations and requires a statement of financial position, a statement of activities and a statement of cash flows. As permitted by GASB Statement No. 34, the Hospital has elected not to present a statement of cash flows for the Foundation in the basic financial statements of the Hospital's reporting entity.

**Floyd Memorial Hospital and Health Services  
A Component Unit of Floyd County, Indiana**

**Notes to Financial Statements  
December 31, 2007 and 2006**

***Investments and Investment Return***

Investments at December 31 consisted of the following:

	<u>2007</u>	<u>2006</u>
Cash and cash equivalents	\$ 111,172	\$ 140,491
Common stocks	1,577,109	1,435,549
Bonds	1,171,553	840,757
Equity mutual funds	<u>1,015,438</u>	<u>845,592</u>
	<u>\$ 3,875,272</u>	<u>\$ 3,262,389</u>

Total investment return at December 31 is comprised of the following:

	<u>2007</u>	<u>2006</u>
Dividends and interest income	\$ 208,269	\$ 113,115
Realized gains on investments	100,987	172,732
Change in market value of investments	<u>38,651</u>	<u>58,226</u>
	<u>\$ 347,907</u>	<u>\$ 344,073</u>

**Note 19: Subsequent Event**

The Hospital issued Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 2003A (2003A Bonds) and 2003B (2003B Bonds) as auction-rate securities. The 2003A Bonds and 2003B Bonds use a bond insurer for credit enhancement and liquidity support. Under the terms of the bond indentures, if for any reason the 2003A Bonds and 2003B Bonds do not remarket on any given remarketing date, the interest rate defaults to a maximum rate as calculated under the trust indentures which is 150% of the AA rated commercial paper rate. On February 2, 2008, and March 18, 2008, the 2003A Bonds and 2003B Bonds, respectively, failed to remarket and defaulted to the maximum rate noted above.