



KING'S DAUGHTERS'

Hospital & Health Services

A family of caring.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

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REPORT OF INDEPENDENT AUDITORS

Board of Managers
The King's Daughters' Hospital and Health
Services and Affiliated Organization
Madison, Indiana

We have audited the accompanying consolidated balance sheets of The King's Daughters' Hospital and Health Services and Affiliated Organization (the "Hospital"), as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2011 and 2010, and the results of its operations, changes in its net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Blue & Co., LLC

April 10, 2012

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2011 AND 2010

| ASSETS | 2011 | 2010 |
|--|----------------|----------------|
| Current assets | | |
| Cash and cash equivalents | \$ 7,506,161 | \$ 8,773,039 |
| Patient accounts receivable, net of estimated uncollectibles of \$7,849,358 in 2011 and \$6,018,680 in 2010 | 10,973,022 | 11,212,808 |
| Inventories | 2,113,551 | 1,970,608 |
| Prepaid expenses and other current assets | 959,241 | 1,014,438 |
| Other assets - current portion | 239,296 | 287,519 |
| Total current assets | 21,791,271 | 23,258,412 |
| Assets whose use is limited | 126,169,120 | 152,056,023 |
| Property and equipment | | |
| Land | 5,442,188 | 5,442,334 |
| Buildings and improvements | 42,619,440 | 42,708,291 |
| Fixtures and equipment | 39,145,333 | 39,259,583 |
| | 87,206,961 | 87,410,208 |
| Less accumulated depreciation | 56,408,610 | 54,959,170 |
| | 30,798,351 | 32,451,038 |
| Construction in progress | 45,306,108 | 10,036,485 |
| Property and equipment, net | 76,104,459 | 42,487,523 |
| Other assets, net of current portion | 4,016,090 | 4,125,848 |
| Investments - long term | 1,000,000 | 1,000,000 |
| | | |
| Total assets | \$ 229,080,940 | \$ 222,927,806 |

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2011 AND 2010

LIABILITIES AND NET ASSETS

| | 2011 | 2010 |
|--|----------------|----------------|
| Current liabilities | | |
| Accounts payable | \$ 5,301,274 | \$ 1,487,374 |
| Accrued payroll and payroll withholdings | 1,096,656 | 1,056,813 |
| Accrued expenses | 7,124,228 | 6,086,890 |
| Estimated third-party payor settlements | 1,045,638 | 300,000 |
| Current portion of obligations under capital leases | 536,897 | 615,639 |
| Total current liabilities | 15,104,693 | 9,546,716 |
| Long-term liabilities | | |
| Obligations under capital leases, net of current portion | 358,968 | 493,098 |
| Long-term debt, net of current portion | 97,894,119 | 97,853,607 |
| Deferred compensation liabilities | 993,354 | 851,683 |
| Total long-term liabilities | 99,246,441 | 99,198,388 |
| | | |
| Total liabilities | 114,351,134 | 108,745,104 |
| Net assets | | |
| Controlling interest net assets | | |
| Unrestricted | 114,586,599 | 114,032,135 |
| Temporarily restricted | 119,738 | 127,154 |
| Permanently restricted | 10,000 | 10,000 |
| Total controlling interest net assets | 114,716,337 | 114,169,289 |
| | | |
| Noncontrolling interest | 13,469 | 13,413 |
| | | |
| Total net assets | 114,729,806 | 114,182,702 |
| | | |
| Total liabilities and net assets | \$ 229,080,940 | \$ 222,927,806 |

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2011 AND 2010

| | 2011 | 2010 |
|---|----------------|----------------|
| Changes in unrestricted net assets | | |
| Operating revenues | | |
| Net patient service revenue | \$ 109,149,858 | \$ 111,975,580 |
| Other revenue | 527,783 | 536,908 |
| Net assets released from restrictions | 47,436 | 52,787 |
| Total operating revenues | 109,725,077 | 112,565,275 |
| Operating expenses | | |
| Salaries and wages | 48,484,945 | 49,187,752 |
| Employee benefits and payroll taxes | 12,146,490 | 12,463,469 |
| Professional medical fees | 665,403 | 853,642 |
| Medical supplies | 3,959,080 | 4,374,337 |
| Other supplies | 1,142,366 | 1,208,101 |
| Drugs | 6,482,645 | 6,298,600 |
| Purchased services | 6,974,880 | 6,153,849 |
| Utilities | 1,513,478 | 1,513,352 |
| Insurance | 1,112,236 | 1,301,390 |
| Depreciation and amortization | 5,092,124 | 4,982,410 |
| Interest | 63,742 | 601,187 |
| Provision for bad debts | 13,857,055 | 13,575,949 |
| Other operating expenses | 5,315,744 | 4,940,265 |
| Total operating expenses | 106,810,188 | 107,454,303 |
| Income from operations | 2,914,889 | 5,110,972 |
| Nonoperating revenues (expenses) | (2,341,585) | 4,967,403 |
| Change in unrestricted net assets | 573,304 | 10,078,375 |
| Changes in temporarily restricted net assets | | |
| Contributions | 40,020 | 62,386 |
| Net assets released from restrictions | (47,436) | (52,787) |
| Change in temporarily restricted net assets | (7,416) | 9,599 |
| Change in net assets | 565,888 | 10,087,974 |
| Less amount attributable to noncontrolling interest | (18,840) | (36,024) |
| Change in net assets attributable to controlling interest | \$ 547,048 | \$ 10,051,950 |

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2011 AND 2010

| | Controlling Interest | Noncontrolling Interest | Total |
|-----------------------------------|-------------------------|----------------------------|-----------------------|
| Net asset balances | | | |
| December 31, 2009 | \$ 104,117,339 | \$ 44,969 | \$ 104,162,308 |
| Consolidated change in net assets | 10,051,950 | 36,024 | \$ 10,087,974 |
| Distributions | -0- | (67,580) | (67,580) |
| December 31, 2010 | \$ 114,169,289 | \$ 13,413 | \$ 114,182,702 |
| Consolidated change in net assets | 547,048 | 18,840 | 565,888 |
| Distributions | -0- | (18,784) | (18,784) |
| December 31, 2011 | <u>\$ 114,716,337</u> | <u>\$ 13,469</u> | <u>\$ 114,729,806</u> |

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2011 AND 2010

| | 2011 | 2010 |
|---|--------------|---------------|
| Cash flows from operating activities | | |
| Total change in net assets | \$ 565,888 | \$ 10,087,974 |
| Adjustments to reconcile total change in net assets to net cash from operating activities | | |
| Depreciation | 5,038,892 | 4,934,235 |
| Amortization | 53,232 | 48,175 |
| Provision for bad debts | 13,857,055 | 13,575,949 |
| Loss on write-off of bond costs on retired bonds | -0- | 790,218 |
| Loss on disposal of capital assets | 154,574 | 7,514 |
| Amortization of bond discount | 40,512 | 6,549 |
| Net realized gains and losses and unrealized gains and losses on investments | 3,218,843 | (4,436,347) |
| Changes in operating assets and liabilities | | |
| Patient accounts receivable | (13,617,269) | (13,043,644) |
| Inventories | (142,943) | (80,753) |
| Prepaid expenses and other current assets | 55,197 | 60,240 |
| Accounts payable | (377,797) | (232,012) |
| Accrued payroll and payroll withholdings | 39,843 | 225,355 |
| Accrued expenses | 1,037,338 | 132,233 |
| Estimated third-party payor settlements | 745,638 | (800,000) |
| Net cash from operating activities | 10,669,003 | 11,275,686 |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (34,187,032) | (9,556,848) |
| Proceeds from sale of capital assets | 20,060 | 9,400 |
| Change in investments | -0- | 9,108,548 |
| Change in assets whose use is limited | 22,668,060 | (97,019,712) |
| Change in other assets | 115,030 | (99,736) |
| Change in deferred compensation liabilities | 141,671 | 121,248 |
| Net cash from investing activities | (11,242,211) | (97,437,100) |
| Cash flows from financing activities | | |
| Principal payments on obligations under capital leases | (664,605) | (563,043) |
| Principal payments on long-term debt | -0- | (12,050,000) |
| Payment on bond issuance costs | (10,281) | (1,851,812) |
| Change in bond discount | -0- | (2,187,942) |
| Borrowings on long-term debt | -0- | 100,035,000 |
| Distributions to minority interest holders | (18,784) | (67,580) |
| Net cash from financing activities | (693,670) | 83,314,623 |
| Net change in cash and cash equivalents | (1,266,878) | (2,846,791) |
| Cash and cash equivalents, beginning of year | 8,773,039 | 11,619,830 |
| Cash and cash equivalents, end of year | \$ 7,506,161 | \$ 8,773,039 |

See accompanying notes to consolidated financial statements.

**THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES
AND AFFILIATED ORGANIZATION**

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2011 AND 2010

| | <u>2011</u> | <u>2010</u> |
|--|---------------------|-------------------|
| Supplemental disclosure of cash flow information | | |
| Cash paid during the year for interest | <u>\$ 310,643</u> | <u>\$ 607,249</u> |
| Supplemental disclosure of noncash operating and investing activities | | |
| Property and equipment acquired under accounts payable | <u>\$ 4,191,697</u> | <u>\$ 483,522</u> |
| Supplemental disclosure of noncash investing and financing activities | | |
| Property and equipment acquired under capital leases | <u>\$ 451,733</u> | <u>\$ 343,147</u> |

See accompanying notes to consolidated financial statements.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

1. NATURE OF OPERATIONS

The King's Daughters' Hospital and Health Services ("KDHHS") is a not-for-profit, acute care hospital owned by the Bethany Circle of King's Daughters' of Madison, Indiana, Inc., located in Madison, Indiana. KDHHS is organized for the purpose of providing healthcare services to the residents of Jefferson County and the surrounding area. KDHHS's primary sources of support are from patient revenues. Patient revenues include funds received from Medicare, state agencies, insurance companies, and the patients themselves.

Madison Catheterization Services, LLC ("MCS"), is a limited liability company owned 51 percent by KDHHS. MCS performs catheterization services for the residents of Jefferson County, Indiana and surrounding areas. MCS's primary source of support is from patient revenues.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by KDHHS and MCS (collectively the "Hospital") in the preparation of the consolidated financial statements are summarized below:

Reporting Entity and Consolidation Policy

The accompanying consolidated financial statements include the accounts of KDHHS and MCS. Intercompany transactions and balances have been eliminated in consolidation.

Management's Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less excluding amounts included in assets whose use is limited.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Investments

Investments include shares of preferred stock in a local bank, with a term of five years and carrying a dividend rate of 7.25 percent. Investments are recorded at cost, which approximates market value.

Patient Accounts Receivable and Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and fee schedule payments. Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Allowances for Patient Uncollectible Accounts

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

Inventories

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

Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the Hospital's Board of Managers for future capital improvements and other long-term uses, over which the Board retains control and may at its discretion subsequently use for other purposes; assets held by trustees under indenture agreements; temporarily restricted assets whose use by the Hospital has been limited by donors to a specific time period or purpose; permanently restricted net assets whose use by the Hospital has been restricted by donors in perpetuity; and deferred compensation assets related to certain deferred compensation agreements.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair market value in the consolidated balance sheets. Investment income or loss, including unrealized gains and losses on trading securities, interest, and dividends is included in nonoperating gains of unrestricted net assets, unless the income is restricted by donor or law.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Property and Equipment

Property and equipment are recorded at cost, except for donations, which are recorded at the fair market value at the date of the donation.

Property and equipment include expenditures for additions and repairs which substantially increase the useful lives of existing property and equipment. Maintenance, repairs, and minor improvements are expensed as incurred.

The property and equipment of the Hospital are being depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association's *Estimated Useful Lives of Depreciable Hospital Assets*.

Cost of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets, if any, are capitalized as a component of the cost of acquiring those assets. For the years ended December 31, 2011 and 2010, interest costs incurred were as follows:

| | <u>2011</u> | <u>2010</u> |
|----------------------------|---------------------|---------------------|
| Interest costs capitalized | \$ 3,837,962 | \$ 851,069 |
| Interest costs expensed | <u>63,742</u> | <u>601,187</u> |
| Interest costs incurred | <u>\$ 3,901,704</u> | <u>\$ 1,452,256</u> |

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity.

Consolidated Statements of Operations

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as operating revenues and expenses and included within the line *income from operations* in the Consolidated Statements of Operations. Peripheral and incidental transactions are reported as nonoperating revenues (expenses). Nonoperating revenues (expenses) which are excluded from *income from operations* include contributions and donations, investment income or loss, and gain or loss on disposal of capital assets.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Performance Indicator

The Consolidated Statements of Operations include *change in unrestricted net assets*. Consistent with industry practice, changes in net assets which are excluded from *change in unrestricted net assets* include, if any, unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets.)

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. Amounts determined to qualify as charity care are reported as deductions from revenue.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give, if any, are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted revenue 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 as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

Income Taxes

KDHHS is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code.

MCS is a limited liability company which is treated as a partnership for income tax purposes. As such, net taxable income or loss is taxed directly to the members and not to MCS. Accordingly, income taxes have not been reflected in the accompanying consolidated financial statements.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Hospital and recognize a tax liability if the Hospital has taken an uncertain tax position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

the tax positions taken by the Hospital, and has concluded that as of December 31, 2011 and 2010, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The Hospital is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

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 and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The Hospital is insured for medical malpractice claims and judgments.

Non-Controlling Interest

Non-controlling interests represent the portion of the equity (net assets) that is attributable to investors that are external to and not included in the Hospital's consolidated financial statements.

Reclassifications

Certain 2010 amounts have been reclassified to provide for consistency with reporting of 2011 information. These reclassifications have no effect on the previously reported total change in net assets or net assets.

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is April 10, 2012.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

3. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited are reported at market value and include the following at December 31, 2011 and 2010:

| | 2011 | % | 2010 | % |
|----------------------------|-----------------------|----------------|-----------------------|----------------|
| Cash and cash equivalents | \$ 32,251,437 | 25.6 % | \$ 20,431,488 | 13.4 % |
| Common stock and options | 11,876,170 | 9.4 | 29,487,515 | 19.4 |
| Mutual funds | 26,406,317 | 20.9 | 10,773,486 | 7.1 |
| Asset-backed securities | 1,357,892 | 1.1 | 1,202,491 | 0.8 |
| International bonds | 38,674 | 0.0 | 49,083 | 0.0 |
| Corporate bonds | 1,083,490 | 0.9 | 898,912 | 0.6 |
| U.S. Government securities | 53,155,140 | 42.1 | 89,213,048 | 58.7 |
| | \$ 126,169,120 | 100.0 % | \$ 152,056,023 | 100.0 % |
| | | | | |
| | 2011 | % | 2010 | % |
| Board-Designated Funds | \$ 47,191,403 | 37.4 % | \$ 48,304,898 | 31.8 % |
| Trustee-Held Funds | 77,854,625 | 61.7 | 102,762,288 | 67.6 |
| Donor-Restricted Funds | 129,738 | 0.1 | 137,154 | 0.1 |
| Deferred Compensation | 993,354 | 0.8 | 851,683 | 0.5 |
| | \$ 126,169,120 | 100.0 % | \$ 152,056,023 | 100.0 % |

Investment income is comprised of the following for the years ended December 31, 2011 and 2010:

| | 2011 | 2010 |
|---|-----------------------|---------------------|
| Dividends and interest income | \$ 1,328,136 | \$ 1,718,531 |
| Realized gains (losses) on investments | 4,213,932 | 1,006,095 |
| Change in net unrealized gains (losses) on investments | (7,432,775) | 3,430,252 |
| Investment fees | (279,822) | (271,595) |
| | \$ (2,170,529) | \$ 5,883,283 |

Board-Designated Funds

The Hospital's Board of Managers approved the funding of depreciation expense to meet the capital asset replacement needs of the facility. Depreciation is funded totally with expenditures for capital assets reducing the funded depreciation balance. All income earned by the Board-designated funds is left to accumulate as additions to the funds.

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Trustee-Held Funds

The trustee-held funds are restricted for the payments of principal, interest, and construction costs related to certain long-term debt agreements.

Donor-Restricted Funds

Donor-restricted funds represent contributions that have been restricted by the donors for a specific purpose.

Deferred Compensation Funds

The deferred compensation funds represent assets that have accumulated under separate deferred compensation plans. The Hospital simply maintains the funds for the participants until they are withdrawn according to the specific terms of each separate deferred compensation agreement. The Hospital records liabilities equal to the deferred compensation assets.

Fair Value Measurements and Disclosures

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

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

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 are as follows:

| | Level 1 | Level 2 | Level 3 | Total |
|--------------------------------|-------------------|------------|------------|-------------------|
| Assets whose use is limited | | | | |
| Common stocks | | | | |
| Basic materials | \$ 297,015 | \$ -0- | \$ -0- | \$ 297,015 |
| Consumer discretionary | 689,308 | -0- | -0- | 689,308 |
| Consumer goods | 424,861 | -0- | -0- | 424,861 |
| Consumer services | 789,666 | -0- | -0- | 789,666 |
| Consumer staples | 312,535 | -0- | -0- | 312,535 |
| Energy | 943,607 | -0- | -0- | 943,607 |
| Financials | 2,037,255 | -0- | -0- | 2,037,255 |
| Health care | 1,178,876 | -0- | -0- | 1,178,876 |
| Industrials | 1,491,394 | -0- | -0- | 1,491,394 |
| Information technology | 1,388,047 | -0- | -0- | 1,388,047 |
| Materials | 579,085 | -0- | -0- | 579,085 |
| Oil and gas | 676,410 | -0- | -0- | 676,410 |
| Technology | 827,258 | -0- | -0- | 827,258 |
| Telecommunication | 104,748 | -0- | -0- | 104,748 |
| Utilities | 136,105 | -0- | -0- | 136,105 |
| | <u>11,876,170</u> | <u>-0-</u> | <u>-0-</u> | <u>11,876,170</u> |
| Mutual funds | | | | |
| Fixed Income | 3,481,187 | -0- | -0- | 3,481,187 |
| REITs | 797,755 | -0- | -0- | 797,755 |
| Commodities | 1,118,429 | -0- | -0- | 1,118,429 |
| Specialty - dividends | 725,945 | -0- | -0- | 725,945 |
| Domestic large cap core | 9,126,060 | -0- | -0- | 9,126,060 |
| Domestic large cap growth | 773,635 | -0- | -0- | 773,635 |
| Domestic large cap value | 794,179 | -0- | -0- | 794,179 |
| Domestic mid cap core | 3,318,591 | -0- | -0- | 3,318,591 |
| Domestic small cap growth | 339,840 | -0- | -0- | 339,840 |
| Domestic small cap value | 349,123 | -0- | -0- | 349,123 |
| Domestic all cap core | 649,430 | -0- | -0- | 649,430 |
| International developed | 3,021,824 | -0- | -0- | 3,021,824 |
| International emerging markets | 1,910,319 | -0- | -0- | 1,910,319 |
| | <u>26,406,317</u> | <u>-0-</u> | <u>-0-</u> | <u>26,406,317</u> |
| Asset backed securities | -0- | 1,357,892 | -0- | 1,357,892 |
| International bonds | | | | |
| Materials | -0- | 38,674 | -0- | 38,674 |

THE KING'S DAUGHTERS' HOSPITAL AND HEALTH SERVICES AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

| | | | | |
|---------------------------------------|----------------------|----------------------|---------------|----------------------|
| Corporate bonds | | | | |
| Consumer discretionary | -0- | 106,393 | -0- | 106,393 |
| Consumer staples | -0- | 96,236 | -0- | 96,236 |
| Energy | -0- | 46,701 | -0- | 46,701 |
| Financials | -0- | 495,703 | -0- | 495,703 |
| Industrials | -0- | 193,409 | -0- | 193,409 |
| Information technology | -0- | 44,208 | -0- | 44,208 |
| Materials | -0- | 51,949 | -0- | 51,949 |
| Telecommunications | -0- | 48,891 | -0- | 48,891 |
| | <u>-0-</u> | <u>1,083,490</u> | <u>-0-</u> | <u>1,083,490</u> |
| U.S. Government Securities | | | | |
| U.S Treasury notes | -0- | 2,634,028 | -0- | 2,634,028 |
| U.S. Treasury inflation notes | -0- | 445,108 | -0- | 445,108 |
| Federal National Mortgage Association | -0- | 16,155,918 | -0- | 16,155,918 |
| Federal Home Loan Mortgage Corp | -0- | 20,018,364 | -0- | 20,018,364 |
| Federal Home Loan Bank Discount | -0- | 13,901,722 | -0- | 13,901,722 |
| | <u>-0-</u> | <u>53,155,140</u> | <u>-0-</u> | <u>53,155,140</u> |
| | <u>\$ 38,282,487</u> | <u>\$ 55,635,196</u> | <u>\$ -0-</u> | <u>\$ 93,917,683</u> |

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

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|-----------------------------|----------------------|----------------------|----------------|-----------------------|
| Assets whose use is limited | | | | |
| Common stock and options | \$ 29,487,515 | \$ -0- | \$ -0- | \$ 29,487,515 |
| Mutual funds | 10,773,486 | -0- | -0- | 10,773,486 |
| Asset-backed securities | -0- | 1,202,491 | -0- | 1,202,491 |
| International bonds | -0- | 49,083 | -0- | 49,083 |
| Corporate bonds | -0- | 898,912 | -0- | 898,912 |
| U.S. Government securities | -0- | 89,213,048 | -0- | 89,213,048 |
| | <u>\$ 40,261,001</u> | <u>\$ 91,363,534</u> | <u>\$ -0-</u> | <u>\$ 131,624,535</u> |

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4. OTHER ASSETS

Other assets consist of the following at December 31, 2011 and 2010:

| | 2011 | 2010 |
|--|------------------|-----------------|
| Bond issue costs, net of accumulated amortization | \$ 1,800,190 | \$1,843,141 |
| Goodwill of physician practices, net of accumulated amortization | 1,354,067 | 1,354,067 |
| Investment in captive insurance company | 335,311 | 335,311 |
| Notes receivable | 765,818 | 880,848 |
| Total other assets | 4,255,386 | 4,413,367 |
| Less: current portion of other assets | (239,296) | (287,519) |
| Other assets, net of current portion | \$ 4,016,090 | \$4,125,848 |

Bond issue costs are being amortized over the 35-year life of the bonds beginning in 2010.

Goodwill relates to the purchase of physician practices in 1997 and 2000. Goodwill is tested each year to determine whether there is any impairment.

The Hospital is an 11 percent owner of Indiana Healthcare Reciprocal Risk Retention Group, a risk retention company created to purchase professional liability and general liability insurance for its members. The Hospital accounts for this investment using the cost method.

Physician recruiting notes receivable are forgiven if the physicians meet the period of service requirement. If the physicians do not meet the period-of-service requirement, the notes are immediately due in full. Other physician notes receivable are paid back over the terms of the notes. All physician notes receivable are in varying amounts maturing through July 2017 and carry interest rates ranging from 3.25 percent to 9.25 percent.

The current portion of other assets represents the amount of notes receivable from physicians expected to be repaid or forgiven in the next fiscal year, according to individual employment contracts.

During 2010, the Hospital repaid the remaining outstanding balance of the 1997 Revenue Bonds. As a result of this repayment, the Hospital incurred a loss of \$790,218 due mostly to the remaining unamortized portion of bond issue costs associated with the 1997 Revenue Bonds. This loss is reported in Nonoperating revenues on the Consolidated Statements of Operations.

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5. OBLIGATIONS UNDER CAPITAL LEASES

The Hospital is the lessee of certain equipment under capital leases expiring in various years through 2016. The assets and liabilities under capital leases are initially recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. Amortization of assets held under capital leases is included in depreciation expense and was \$570,503 and \$500,227 for the years ended December 31, 2011 and 2010, respectively.

Following is a summary of property held under capital leases:

| | 2011 | 2010 |
|--------------------------------|-------------|-------------|
| Equipment | \$3,027,873 | \$2,591,140 |
| Less: accumulated amortization | 2,066,869 | 1,506,902 |
| | \$ 961,004 | \$1,084,238 |

Minimum future lease payments under capital leases as of December 31, 2011 are as follows:

| Year Ending December 31, | Amount |
|---|------------|
| 2012 | \$ 585,229 |
| 2013 | 127,783 |
| 2014 | 112,283 |
| 2015 | 107,572 |
| 2016 | 41,346 |
| | 974,213 |
| Less: amount representing interest | 78,348 |
| Present value of minimum lease payments | \$ 895,865 |

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6. LONG-TERM DEBT

At December 31, 2011 and 2010, the Hospital was obligated for long-term debt agreements as follows:

| | 2011 | 2010 |
|--|----------------|---------------|
| Indiana Finance Authority Hospital Revenue Bonds, dated October 2010, payable in annual principal installments commencing August 2015 through August 2045, in amounts ranging from \$1,370,000 to \$6,400,000. Serial remaining fixed interest rates ranging from 4.5% to 5.5%. Secured by gross revenues. | \$ 100,035,000 | \$100,035,000 |
| Less unamortized bond discounts | (2,140,881) | (2,181,393) |
| Long-term debt, net of current portion | \$ 97,894,119 | \$ 97,853,607 |

Maturities of long-term debt for each of the five years subsequent to December 31, 2011, are as follows:

| Year Ending December 31, | Principal Amount |
|----------------------------|------------------|
| 2012 | \$ -0- |
| 2013 | -0- |
| 2014 | -0- |
| 2015 | 1,370,000 |
| 2016 | 1,430,000 |
| Thereafter | 97,235,000 |
| Unamortized bond discounts | (2,140,881) |
| Total | \$ 97,894,119 |

Under the terms of the Series 2010 Bonds, the Hospital is required to maintain certain deposits with a trustee. Such deposits are reported in the consolidated financial statements as assets whose use is limited. These agreements also place limits on the occurrence of additional borrowings and require that the Hospital satisfy certain covenants, including debt service coverage ratio, days cash on hand, and submission of audited financial statements.

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7. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are donor-restricted for a specific use or by the passage of time. Permanently restricted net assets are donor-restricted assets whereby the principal amount is never to be expended. Income earned from these principal amounts includes both temporarily restricted and unrestricted amounts. Temporarily and permanently restricted net assets include the following at December 31, 2011 and 2010:

| | 2011 | 2010 |
|---|------------|------------|
| Temporarily restricted | | |
| Prenatal/Postnatal Education Program Fund | \$ 1,933 | \$ 2,012 |
| Tobacco Settlement Fund | 100,868 | 108,843 |
| Teen Event Fund | 6,751 | 6,751 |
| Girls on the Run Fund | 5,555 | 4,926 |
| May Library Fund | 4,631 | 4,622 |
| Total temporarily restricted net assets | \$ 119,738 | \$ 127,154 |
| Permanently restricted | | |
| Heberhart Endowment | \$ 10,000 | \$ 10,000 |

8. ENDOWMENT

The Hospital's endowment consists of one individual donor-restricted fund established by the donor to function as an endowment. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds, including funds designated by the Board of Managers to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Managers has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets, if any, is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds.

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- (1) The duration and preservation of the fund
- (2) The purposes of the Hospital and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Hospital
- (7) The investment policies of the Hospital

The Hospital has adopted investment and spending policies for endowment assets that attempt to balance the mission of building capital for future use with the corresponding obligation to support current and future needs of the Hospital. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period. Under this policy, as approved by the Board of Managers, the endowment assets are invested in a manner that is intended to produce long-term growth of capital without undue exposure to risk.

To satisfy its long-term rate of return objectives, the Hospital relies on a total return strategy in which investment decisions shall be made with the intent of maximizing the long-term total return of the portfolio through market value changes (realized and unrealized) and through earned income (dividends and interest).

On balances of endowed funds, as of the beginning of each fiscal year, an amount as determined by the Hospital Board will be distributed for the intended purposes of the endowment annually. Growth of the endowment will come from the annual earnings of investments in excess of distributions plus contributions made to the endowment.

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Endowment Net Asset Composition by Type of Fund as of December 31, 2011:

| | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|----------------------------------|-----------------------------------|-----------------------------------|------------------|
| Donor restricted endowment funds | <u>\$ -0-</u> | <u>\$ 10,000</u> | <u>\$ 10,000</u> |

Changes in Endowment Net Assets for the Year Ended December 31, 2011:

| | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|--|-----------------------------------|-----------------------------------|------------------|
| Endowment net assets, beginning of year | \$ -0- | \$ 10,000 | \$ 10,000 |
| Contributions | -0- | -0- | -0- |
| Investment income | -0- | -0- | -0- |
| Appropriation of endowment assets for expenditure | -0- | -0- | -0- |
| Endowment net assets, end of year | <u>\$ -0-</u> | <u>\$ 10,000</u> | <u>\$ 10,000</u> |

Endowment Net Asset Composition by Type of Fund as of December 31, 2010:

| | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|----------------------------------|-----------------------------------|-----------------------------------|------------------|
| Donor restricted endowment funds | <u>\$ -0-</u> | <u>\$ 10,000</u> | <u>\$ 10,000</u> |

Changes in Endowment Net Assets for the Year Ended December 31, 2010:

| | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|--|-----------------------------------|-----------------------------------|------------------|
| Endowment net assets, beginning of year | \$ -0- | \$ 10,000 | \$ 10,000 |
| Contributions | -0- | -0- | -0- |
| Investment income | -0- | -0- | -0- |
| Appropriation of endowment assets for expenditure | -0- | -0- | -0- |
| Endowment net assets, end of year | <u>\$ -0-</u> | <u>\$ 10,000</u> | <u>\$ 10,000</u> |

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| Permanently restricted net assets | 2011 | 2010 |
|---|------------------|------------------|
| The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or UPMIFA | <u>\$ 10,000</u> | <u>\$ 10,000</u> |

9. NET PATIENT SERVICE REVENUE

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

- **Medicare.** The Hospital is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Hospital is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicare outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. As of December 31, 2011, the Hospital's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2006.
- **Medicaid.** The Hospital is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Hospital is reimbursed for Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. There is no cost settlement for either of the inpatient or outpatient programs.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs. The Hospital believes that it is in compliance with all applicable laws and regulations.

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The Hospital has also entered into preferred provider agreements with certain commercial insurance carriers. Payment arrangements to the Hospital under these agreements include discounted charges and fee schedule payments.

10. CHARITY CARE

The Hospital provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue.

The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total operating expenses (less bad debt expense) divided by gross patient service revenue. For the years ended December 31, 2011 and 2010, the Hospital incurred estimated costs of \$1,261,085 and \$1,329,452, respectively, from providing services to charity patients.

11. PENSION PLAN

The Hospital sponsors a defined contribution pension plan that covers all eligible employees who work over 1,000 hours a year. Physicians are eligible for enrollment immediately after their hire date. Prior to February 1, 2010, all other employees must have completed one year of employment and be 21 years of age. Beginning February 1, 2010, all employees are eligible for enrollment on the first day of the month following their hire date. The Hospital contributes 2 percent for each eligible employee. The employee may contribute up to 15 percent with a maximum of 6 percent being matched at a rate of 50 percent. For the years ended December 31, 2011 and 2010, the amount of pension expense was \$2,201,651 and \$2,951,337, respectively.

12. DEFERRED COMPENSATION AGREEMENTS

Previously, the Hospital maintained an informal deferred compensation plan whereby amounts were withdrawn from participating physicians' pay and held by the Hospital until such time that the participating physicians retired. The Hospital no longer offers this plan, but still records a liability for any amounts which were unpaid at year-end. The deferred compensation asset and liability amounts under this agreement were both \$119,997 and \$149,539 at December 31, 2011 and 2010, respectively.

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The Hospital funds an executive deferred compensation plan. The plan accumulates cash value over time. The Hospital records an asset and liability amount equal to the market value of the deferred compensation plan. The deferred compensation asset and liability amounts under this agreement were both \$774,986 and \$596,141 at December 31, 2011 and 2010, respectively.

Previously, the Hospital maintained a deferred compensation plan for a select group of key management employees. Under the terms of the plan, the Hospital contributed 4 percent of a participant's compensation, as defined in the agreement, each calendar quarter. The Hospital no longer offers this plan, but still records a liability for any amounts that were unpaid at year-end. The deferred compensation asset and liability amounts under this agreement were both \$98,371 and \$106,003 at December 31, 2011 and 2010, respectively.

13. PROFESSIONAL LIABILITY INSURANCE

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

The Hospital maintains professional liability insurance through a multiprovider reciprocal risk retention group (the "Group"), in which premiums are accrued based on the Group's experience to date. This provides protection from liability in amounts not to exceed as follows:

| | 2011 | 2010 |
|--|---------------|---------------|
| Hospital per occurrence | \$ 250,000 | \$ 250,000 |
| Hospital aggregate | \$ 5,000,000 | \$ 5,000,000 |
| Group umbrella aggregate | \$ 10,000,000 | \$ 10,000,000 |
| Group first additional umbrella aggregate | 10,000,000 | 10,000,000 |
| Group second additional umbrella aggregate | 10,000,000 | 10,000,000 |
| Total Group umbrella aggregate | \$ 30,000,000 | \$ 30,000,000 |

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Liabilities for incurred but not reported losses at December 31, 2011 and 2010 are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Hospital's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Hospital intends to continue carrying such insurance.

14. OPERATING LEASES

The Hospital leases certain equipment under noncancelable operating leases expiring in various years through 2014. Minimum future rental payments under these noncancelable operating leases as of December 31, 2011, are as follows:

| <u>Year Ending December 31,</u> | <u>Amount</u> |
|---------------------------------|-------------------|
| 2012 | \$ 158,361 |
| 2013 | 39,578 |
| 2014 | <u>22,355</u> |
| Total minimum lease payments | <u>\$ 220,294</u> |

The Hospital incurred \$513,682 and \$463,502 in total rent expense for the years ended December 31, 2011 and 2010, respectively, under both cancelable and noncancelable leases.

15. CONCENTRATIONS OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements. The mix of gross revenues and receivables from patients and third-party payors at December 31, 2011 and 2010, was as follows:

| | <u>2011</u> | | <u>2010</u> | |
|------------------|----------------|--------------------|----------------|--------------------|
| | <u>Revenue</u> | <u>Receivables</u> | <u>Revenue</u> | <u>Receivables</u> |
| Medicare | 46 % | 38 % | 46 % | 35 % |
| Medicaid | 14 | 10 | 13 | 11 |
| Blue Cross | 15 | 10 | 14 | 10 |
| Other Commercial | 19 | 19 | 21 | 21 |
| Self-Pay | <u>6</u> | <u>23</u> | <u>6</u> | <u>23</u> |
| | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> |

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The Hospital maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Hospital has not experienced any losses on such accounts. The Hospital believes it is not exposed to any significant credit risk on cash.

16. FUNCTIONAL EXPENSES

The Hospital provides general healthcare services to residents within its geographic area. Expenses related to providing these services are broken down as follows for the years ended December 31, 2011 and 2010:

| | <u>2011</u> | <u>2010</u> |
|----------------------------|----------------------|-----------------------|
| Healthcare services | \$ 95,240,925 | \$ 96,206,158 |
| General and administrative | <u>11,569,263</u> | <u>11,248,145</u> |
| | <u>\$106,810,188</u> | <u>\$ 107,454,303</u> |

17. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Cash and Cash Equivalents

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

Assets Whose Use is Limited

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

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

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

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Estimated Third-Party Payor Settlements

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

Long-Term Debt and Obligations Under Capital Leases

The carrying amount and fair value reported in the consolidated balance sheets for the combined amounts of long-term debt and obligations under capital leases were based on incremental borrowing rates available to similar entities with similar credit ratings. The combined amounts of long-term debt and obligations under capital leases were \$98,789,984 and \$99,398,841, respectively, for 2011 and \$98,962,344 and \$98,419,161, respectively, for 2010.

Deferred Compensation Liabilities

The carrying amount reported in the consolidated balance sheets for deferred compensation liabilities approximates its fair value based on quoted market prices, if available, or are estimated using quoted market prices for similar securities and the cash surrender value of the Hospital's insurance policies.

18. CONTINGENCIES

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

19. COMMITMENTS

As of December 31, 2011, the Hospital has construction and renovation project commitments as follows:

| <u>Project</u> | <u>Expected Date of Completion</u> | <u>Estimated Total Cost of Project</u> | <u>Costs Incurred as of December 31, 2011</u> |
|------------------------|--|--|---|
| Hilltop MOB/Hospital | 2013 | \$ 100,000,000 | \$ 38,359,781 |
| Meditech EHR Migration | 2012 | 10,000,000 | 6,885,302 |
| All others | Various | 65,000 | 61,025 |
| | | | <u>\$ 45,306,108</u> |