Hillsdale Community Health Center

Financial Report
June 30, 2008

Hillsdale Community Health Center

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Independent Auditor's Report

To the Board of Trustees
Hillsdale Community Health Center

We have audited the accompanying balance sheet of Hillsdale Community Health Center (the "Hospital") as of June 30, 2008 and 2007 and the related statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 Hillsdale Community Health Center at June 30, 2008 and 2007 and the results of its operations, changes in net assets, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

September 11, 2008

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

Hillsdale Community Health Center

Balance Sheet

	June 30, 2008	June 30, 2007
Assets		
Current Assets		
Cash and cash equivalents	$ 4,153,643	$ 4,470,278
Accounts receivable (Note 2)	8,189,149	7,342,651
Assets limited as to use (Note 3)	2,480,558	1,917,364
Other current asset	1,419,863	1,488,179
Total current assets	16,243,213	15,218,472
Investments (Note 3)	10,917,158	11,292,063
Property and Equipment - Net (Note 4)	17,156,404	18,115,798
Other Assets (Note 5)	2,220,348	2,452,508
Total assets	**$ 46,537,123**	**$ 47,078,841**
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 7)	$ 492,369	$ 657,473
Accounts payable	3,290,882	2,854,324
Estimated third-party payor settlements (Note 6)	1,615,434	3,349,000
Accrued liabilities and other	5,808,112	4,780,747
Total current liabilities	11,206,797	11,641,544
Long-term Debt - Net of current portion (Note 7)	14,598,244	15,077,953
Total liabilities	25,805,041	26,719,497
Net Assets		
Unrestricted	20,395,633	20,200,459
Temporarily restricted (Note 9)	336,449	158,885
Total net assets	20,732,082	20,359,344
Total liabilities and net assets	**$ 46,537,123**	**$ 47,078,841**

See Notes to Financial Statements.

Hillsdale Community Health Center

Statement of Operations

	Year Ended June 30, 2008	Year Ended June 30, 2007
Unrestricted Revenue, Gains, and Other Support		
Net patient service revenue	$ 53,779,304	$ 48,189,832
Other	633,772	672,008
DSH revenue (Note 1)	859,698	2,011,506
Total unrestricted revenue, gains, and other support	55,272,774	50,873,346
Expenses		
Salaries and wages	18,196,652	17,082,172
Employee benefits and payroll taxes	4,543,934	4,749,071
Operating supplies and expenses	21,838,696	21,518,669
Depreciation and amortization	2,760,357	2,476,358
Provision for bad debts	5,234,267	2,744,710
Interest expense	720,344	736,649
Contribution to county health plans (Note 1)	859,698	2,011,506
Total expenses	54,153,948	51,319,135
Operating Income (Loss)	1,118,826	(445,789)
Nonoperating Income (Expense)		
Investment income (Note 3)	1,195,714	748,824
Contributions	4,720	123,052
Other income	-	17,088
Rent income	18,237	9,668
Physician recruitment expense	(1,218,101)	(1,590,134)
Net nonoperating income (expense)	570	(691,502)
Excess of Revenue Over (Under) Expenses	1,119,396	(1,137,291)
Change in Unrealized Gains and Losses on Investments (Note 3)	(1,172,819)	835,592
Net Assets Released from Restriction	248,597	568,593
Increase in Unrestricted Net Assets	**$ 195,174**	**$ 266,894**

See Notes to Financial Statements.

Hillsdale Community Health Center

Statement of Changes in Net Assets

	Year Ended	
	June 30, 2008	June 30, 2007
Unrestricted Net Assets		
Excess of revenue over (under) expenses	$ 1,119,396	$ (1,137,291)
Change in unrealized gains and losses on investments (Note 3)	(1,172,819)	835,592
Net assets released from restriction	248,597	568,593
Increase in Unrestricted Net Assets	195,174	266,894
Temporarily Restricted Net Assets		
Restricted contributions	426,161	615,960
Net assets released from restriction	(248,597)	(568,593)
Increase in Temporarily Restricted Net Assets	177,564	47,367
Increase in Net Assets	372,738	314,261
Net Assets - Beginning of year	20,359,344	20,045,083
Net Assets - End of year	**$ 20,732,082**	**$ 20,359,344**

See Notes to Financial Statements.

Hillsdale Community Health Center

Statement of Cash Flows

	Year Ended June 30, 2008	Year Ended June 30, 2007
Cash Flows from Operating Activities		
Cash received from patients and third-party payors	$ 51,199,240	$ 49,453,293
Cash paid to suppliers and employees	(49,583,595)	(46,789,206)
Investment income received	582,174	600,362
Interest paid	(720,344)	(736,649)
Cash received from other operating income	1,493,470	2,680,489
Net cash provided by operating activities	2,970,945	5,208,289
Cash Flows from Investing Activities		
Purchase of property and equipment	(1,993,236)	(4,956,129)
Proceeds from sale of property and equipment	140,000	44,000
Purchase of investments	(812,367)	(1,495,815)
Proceeds from sale of investments	64,799	-
Loans to physicians - Land contracts	(125,831)	-
Advances to physicians	(533,772)	(844,276)
Proceeds from land contracts	190,479	12,266
Increase (decrease) in deposits	1,000	(7,500)
Net cash used in investing activities	(3,068,928)	(7,247,454)
Cash Flows from Financing Activities		
Proceeds from issuance of debt obligations	-	1,894,339
Principal payments on debt obligations	(644,813)	(692,934)
Proceeds from restricted contributions	426,161	615,960
Net cash (used in) provided by financing activities	(218,652)	1,817,365
Net Decrease in Cash and Cash Equivalents	(316,635)	(221,800)
Cash and Cash Equivalents - Beginning of year	4,470,278	4,692,078
Cash and Cash Equivalents - End of year	**$ 4,153,643**	**$ 4,470,278**

See Notes to Financial Statements.

Note 1 - Nature of Business and Significant Accounting Policies

Hillsdale Community Health Center (the "Hospital") operates a short-term, acute-care facility including a skilled-nursing unit providing inpatient and outpatient healthcare services to the Hillsdale, Michigan area.

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

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use.

Patient Accounts Receivable - Accounts receivable for patients are stated at net amounts. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts stratified by payor and number of days the accounts are outstanding. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. An allowance for contractual adjustments is also established on an aggregate basis and is computed based on agreements with third-party payors that provide payment to the Hospital at amounts different than the established charges. Contractual adjustments are written off against the allowance for contractual adjustments in the period payment is received.

Investments - Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in excess of revenue over (under) expenses unless the income or loss is restricted by donor or law. Unrealized gains or losses on investments are excluded from excess of revenue over (under) expenses.

Property and Equipment - Property and equipment amounts are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method.

Bond Issue Costs - Bond issue costs are included in other assets (see Note 5). These costs are being amortized over the life of the debt. Amortization expense was $15,269 for the years ended June 30, 2008 and 2007.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Self-insurance - The Hospital acts as a self-insurer for the health insurance benefits up to limits as provided for an agreement with its insurance plan administrator. The cost of claims, including an estimate for unprocessed claims, is recognized as an operating expense in the year of the incident. A cost-to-charge ratio of approximately .50 is applied to all domestic claims and recorded as healthcare benefits along with foreign claims paid. The balance was adjusted to net patient revenue.

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 per diem payments. Net patient service revenue is 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. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Services provided on a charity basis during 2008 and 2007 amounted to $982,355 and $793,173, respectively, based on established rates.

Contributions to County Health Plans - The Hospital has entered into an indigent care agreement with three area counties. To fund the operations of the county health plans, the State provides the Hospital with a contribution from designated state and federal funds, called disproportionate share hospital funds (DSH). The Hospital then disburses these funds directly to the county health plans. The county health plans rely on these funds to be able to provide access to basic community-based healthcare services to a population that might not otherwise obtain healthcare services.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Excess of Revenue Over (Under) Expenses - The statement of operations includes excess of revenue over (under) expenses. Changes in unrestricted net assets, which are excluded from excess of revenue over (under) expenses, consistent with industry practice, include net assets released from restrictions for the acquisition of long-lived assets and changes in unrealized gains and losses on investments.

Contributions - The Hospital reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of changes in net assets as net assets released from restrictions.

The Hospital reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Hospital reports the expiration of donor restrictions when the assets are placed in service.

Tax Status - The Hospital and its subsidiaries are nonprofit, tax-exempt organizations; accordingly, no tax provision is reflected in the financial statements.

Reclassification - Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

Note 2 - Patient Accounts Receivable

The details of patient accounts receivable are as follows:

	2008	2007
Patient accounts receivable	$ 25,000,149	$ 18,723,651
Less:		
Allowance for uncollectible accounts	(4,510,000)	(2,159,000)
Allowance for contractual adjustments and interim payment advances	(12,301,000)	(9,222,000)
Net patient accounts receivable	$ 8,189,149	$ 7,342,651

Note 2 - Patient Accounts Receivable (Continued)

The Hospital is located in Hillsdale, Michigan. The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	Percentage	
	2008	2007
Medicare	16	22
Blue Cross/Blue Shield of Michigan	13	22
Medicaid	7	7
Commercial insurance and HMOs	13	16
Self-pay	51	33
Total	100	100

Note 3 - Investments

The details of investments are as follows:

	2008	2007
Assets limited as to use:		
Professional and general liability self-insurance	$ 2,480,558	$ 1,917,364
Debt service reserve and payment funds	957,714	957,714
Donor-restricted assets	93,328	158,885
Board-designated assets	27,661	27,710
Deferred compensation	10,727	18
Other investments	9,827,728	10,147,736
Less current portion	(2,480,558)	(1,917,364)
Net	$ 10,917,158	$ 11,292,063
Cash and cash equivalents	$ 3,969,193	$ 3,812,826
Corporate bonds	1,258,221	2,383,061
Mutual funds - Equity	1,829,796	1,650,677
Governmental bonds	1,862,165	1,568,206
Corporate stocks	4,478,341	3,794,657
Total	$ 13,397,716	$ 13,209,427

Note 3 - Investments (Continued)

The details of investment income are as follows:

	2008	2007
Interest and dividend income	$ 582,174	$ 600,362
Net realized gains on investments	613,540	148,462
Total	1,195,714	748,824
Net unrealized gains and losses on investments	(1,172,819)	835,592
Net	$ 22,895	$ 1,584,416

Note 4 - Property and Equipment

The cost of property, plant, and equipment and depreciable lives are summarized as follows:

	2008	2007	Depreciable Life - Years
Land	$ 103,162	$ 103,162	-
Land improvements	272,885	272,885	5
Buildings	25,119,271	24,443,571	5-50
Equipment	16,392,067	15,287,507	5-10
Capital leases	827,797	827,797	5-10
Construction in progress	-	5,054	-
Total cost	42,715,182	40,939,976	
Accumulated depreciation	(25,558,778)	(22,824,178)	
Net property and equipment	$ 17,156,404	$ 18,115,798	

Note 5 - Other Assets

The details of other assets are as follows:

	2008	2007
Physician advances - Net of current portion of $900,000 for the years ended June 30, 2008 and 2007	$ 773,177	$ 1,167,541
Land contract receivables	887,682	952,330
Pledges receivable	243,121	-
Bond issuance costs	230,176	245,445
Deposits	86,192	87,192
Total other assets	$ 2,220,348	$ 2,452,508

Note 6 - Cost Report Settlements

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Approximately 66 percent of the Hospital's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs. The Hospital has agreements with third-party payors that provide for reimbursement at amounts different from established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient and acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Inpatient psychiatric and substance abuse services are reimbursed at cost subject to a per-case limit. Outpatient and home care services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.

- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Outpatient and physician services are reimbursed on an established fee-for-service methodology.

- **Blue Cross/Blue Shield of Michigan** - Inpatient, acute-care services are reimbursed at prospectively determined rates per discharge. Outpatient services are reimbursed on a fee-for-service and percentage-of-charge basis.

Note 7 - Long-term Debt

A summary of long-term debt obligations at June 30, 2008 and 2007 is as follows:

	2008	2007
Series 1998 Bonds payable to the City of Hillsdale Hospital Finance Authority, interest at 5.0 percent to 5.75 percent, annual principal payments ranging from $330,000 in 2009 to $795,000 in 2026, collateralized by all assets and revenue of the Hospital	$ 9,553,074	$ 9,855,417
Michigan State Hospital Finance Authority, Healthcare Equipment and Loan Program (HELP), Series C, payable in monthly payments of $19,988, plus interest at 2.95 percent, balance due in 2023, collateralized by all assets and revenue of the Hospital	3,689,214	3,929,192
Michigan State Hospital Finance Authority, Healthcare Equipment and Loan Program (HELP), Series C, payable in monthly payments of $8,120, plus interest at 2.95 percent, balance due in July 2026, collateralized by all assets and revenue of the Hospital	1,749,995	1,847,432
Note payable, interest at 7.00 percent adjusting every five years to 1 percent over prime, payable in monthly installments of $1,011, collateralized by property purchased	98,330	103,385
Total	15,090,613	15,735,426
Less current portion	492,369	657,473
Long-term portion	$ 14,598,244	$ 15,077,953

Currently, the HELP loan is secured with a letter of credit up to $5,000,000, expiring in November 2011, and the Hospital pays 1.4 percent on the outstanding principal balance of the loan. The additional percentage is included in interest expense during the year.

Note 7 - Long-term Debt (Continued)

Principal payments on notes payable and lease payments on capital leases over the next five years and in aggregate as of June 30, 2008 are as follows:

Years Ending June 30	Amount
2009	$ 492,369
2010	534,883
2011	560,808
2012	586,926
2013	608,248
Thereafter	12,307,379
Total	$ 15,090,613

Note 8 - Operating Leases

The Hospital is obligated under certain operating leases, primarily for facilities, office equipment, and automobiles. Total rent expense under these leases was $928,433 and $462,720 for the years ended June 30, 2008 and 2007, respectively.

Future minimum rental commitments are as follows:

Years Ending June 30	Amount
2009	$ 990,999
2010	860,091
2011	381,077
2012	145,519
2013	66,932
Total	$ 2,444,618

Note 9 - Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at June 30, 2008 and 2007:

	2008	2007
Healthcare programs	$ 34,617	$ 33,759
Purchase of equipment and expansion	301,832	125,126
Total temporarily restricted net assets	$ 336,449	$ 158,885

Note 10 - Defined Contribution Pension Plan

The Hospital has established a defined contribution retirement plan covering substantially all employees. The Hospital contributed 3 percent of eligible wages, resulting in pension expense of approximately $376,000 and $435,000 for the years ended June 30, 2008 and 2007, respectively.

Note 11 - Professional Liability

Effective June 1, 2004, the Hospital is self-insured with respect to medical malpractice risk. The Hospital has purchased self-insurance retention insurance for claims greater than $1 million per occurrence. Losses from asserted claims and from unasserted claims identified under the Hospital's incident reporting system are accrued based on estimates that incorporate the Hospital's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors.

The Hospital has established an off-shore company, HCHC Assurance Company LTD, for the payment of medical malpractice claim settlements. An actuary has been retained to assist the Hospital with determining the estimated malpractice liability. Professional liability investments have been established in an amount equal to or greater than the provision for medical malpractice.

The Hospital has been named in several malpractice lawsuits. At this time, it is premature to evaluate the likely outcome and amount of settlement, if any. Management intends to vigorously defend these suits and does not expect an unfavorable impact.

Note 12 - Commitments and Contingencies

The Hospital has entered into agreements with newly recruited physicians that include provisions for income guarantees ranging from one to three years. The maximum amounts of such guarantees entered into during the years ended June 30, 2008 and 2007 total approximately $0 and $285,000, respectively. The Hospital has recorded a liability for future payments totaling approximately $162,000 and $367,000 for the years ended June 30, 2008 and 2007, respectively. The amounts advanced to the physicians depend on income levels earned in their practices. Per contractual agreements, these advances are amortized over two to six years if the physician remains practicing in the area; otherwise, the unamortized balance can be collected by the Hospital. Amortization of these advances, which is included in physician recruitment expenses, approximated $928,000 and $1,378,000 for 2008 and 2007, respectively.

Note 12 - Commitments and Contingencies (Continued)

The Hospital has entered into guarantee agreements with two financial institutions. The Hospital has guaranteed the obligations of an unrelated party to construct a medical office building up to $4.8 million. In the event that the Hospital is required to make payments under this guarantee, the Hospital could seek to recover those amounts; however, the Hospital does not have specific recourse or collateral rights in connection with the guarantee. The Hospital is unaware of any default or potential default resulting in any Hospital liability. The balance of the mortgage outstanding at June 30, 2008 was approximately $4.76 million.

Note 13 - Functional Expenses

The Hospital provides general healthcare services to residents within its geographic area, including residential care, assisted living, and independent living. Expenses related to providing these services for the years ended June 30, 2008 and 2007 are as follows.

	2008	2007
Healthcare services	$ 48,205,602	$ 45,317,211
General and administrative	5,948,346	6,001,924
Total	$ 54,153,948	$ 51,319,135

Note 14 - Cash Flows

A reconciliation of increase in net assets to net cash from operating activities is as follows:

	2008	2007
Increase in net assets	$ 372,738	$ 314,261
Adjustments to reconcile increase in net assets to net cash from operating activities:		
Depreciation	2,760,357	2,476,358
Realized and unrealized net gains and losses on investments	559,279	(984,054)
Loss on the sale of fixed assets	52,273	3,676
Bad debt expense	5,234,267	2,744,710
Temporarily restricted donations	(426,161)	(615,960)
Amortization of bond costs	15,269	15,269
Pledges receivable	(243,121)	-
Amortization of physician advances	928,136	1,377,954
(Increase) decrease in assets:		
Accounts receivable	(6,080,765)	(2,179,598)
Other current assets	68,316	293,222
Increase (decrease) in liabilities:		
Accounts payable	436,558	361,070
Accrued liabilities	1,027,365	702,381
Cost report settlements payable	(1,733,566)	699,000
Net cash provided by operating activities	$ 2,970,945	$ 5,208,289

Significant noncash financing and investing activities for the years ended June 30, 2008 and 2007 are as follows:

- During the year ended June 30, 2007, the Hospital sold assets on land contracts totaling $470,000.

Note 15 - Subsequent Event

In July 2008, the Hospital entered into an agreement with Winthrop Resources Corporation for the purchase of equipment. The Hospital is borrowing approximately $2,000,000. As of the report date, the Hospital has not drawn any funds on the loan.