ARKANSAS VALLEY REGIONAL MEDICAL CENTER

Financial Statements

For the Years Ended March 31, 2008 and 2007

And

Independent Auditors' Report

ARKANSAS VALLEY REGIONAL MEDICAL CENTER

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stockman kast ryan + co LLP

INDEPENDENT AUDITORS' REPORT

Board of Directors
Arkansas Valley Regional Medical Center

We have audited the accompanying balance sheets of Arkansas Valley Regional Medical Center as of March 31, 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 Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Arkansas Valley Regional Medical Center as of December 31, 2007 and 2006 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.

Stockman Kast Ryan + Co., LLP

July 21, 2008

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ARKANSAS VALLEY REGIONAL MEDICAL CENTER

BALANCE SHEETS
MARCH 31, 2008 AND 2007

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,320,425	$ 2,551,050
Investments	406,482	387,565
Current portion of assets limited as to use	671,042	651,876
Patient accounts receivable — net	5,503,648	4,773,426
Inventories	1,140,151	1,128,165
Estimated third-party payor settlements	216,490	
Prepaids and other	810,843	669,007
Total current assets	11,069,081	10,161,089
ASSETS LIMITED AS TO USE		
Internally designated	6,878,875	6,632,875
Held by trustee for debt service	848,687	814,737
Total assets limited as to use	7,727,562	7,447,612
PROPERTY AND EQUIPMENT — net	24,340,752	25,443,671
DEFERRED FINANCING COSTS — net	166,670	179,766
TOTAL ASSETS	$ 43,304,065	$ 43,232,138
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 801,661	$ 863,291
Accounts payable	923,134	908,634
Accrued liabilities	2,365,680	2,117,042
Estimated third-party payor settlements		3,258
Total current liabilities	4,090,475	3,892,225
LONG-TERM DEBT	9,142,333	9,915,971
Total liabilities	13,232,808	13,808,196
UNRESTRICTED NET ASSETS	30,071,257	29,423,942
TOTAL LIABILITIES AND NET ASSETS	$ 43,304,065	$ 43,232,138

See notes to financial statements.

ARKANSAS VALLEY REGIONAL MEDICAL CENTER

STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED MARCH 31, 2008 AND 2007

	2008	2007
OPERATING REVENUES		
Net patient service revenue	$ 34,234,512	$ 32,946,951
Other operating revenue	265,097	191,419
Total operating revenues	34,499,609	33,138,370
OPERATING EXPENSES		
Salaries and wages	14,834,333	15,161,985
Medical supplies and drugs	7,438,059	6,919,687
Employee benefits	3,638,969	3,405,651
Purchased services and professional fees	3,238,436	3,269,203
Provision for bad debts	2,436,873	1,661,197
Depreciation and amortization	2,154,188	2,203,085
Interest expense	603,350	635,682
Total operating expenses	34,344,208	33,256,490
INCOME (LOSS) FROM OPERATIONS	155,401	(118,120)
OTHER INCOME		
Investment income	614,090	469,053
Other	20,041	28,846
Total other income	634,131	497,899
EXCESS OF REVENUES OVER EXPENSES	789,532	379,779
CHANGE IN NET UNREALIZED GAINS (LOSSES) ON INVESTMENT SECURITIES	(147,302)	42,630
GRANT PROCEEDS EXPENDED FOR EQUIPMENT	5,085	207,883
INCREASE IN UNRESTRICTED NET ASSETS	$ 647,315	$ 630,292

See notes to financial statements.

ARKANSAS VALLEY REGIONAL MEDICAL CENTER

STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED MARCH 31, 2008 AND 2007

	2008	2007
UNRESTRICTED NET ASSETS		
Excess of revenues over expenses	$ 789,532	$ 379,779
Change in unrealized gains (losses) on investment securities	(147,302)	42,630
Grant proceeds expended for equipment	5,085	207,883
INCREASE IN UNRESTRICTED NET ASSETS	647,315	630,292
NET ASSETS, BEGINNING OF YEAR	29,423,942	28,793,650
NET ASSETS, END OF YEAR	$ 30,071,257	$ 29,423,942

See notes to financial statements.

ARKANSAS VALLEY REGIONAL MEDICAL CENTER

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED MARCH 31, 2008 AND 2007

	2008	2007
OPERATING ACTIVITIES		
Change in net assets	$ 647,315	$ 630,292
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	2,154,188	2,203,085
Provision for bad debts	2,436,873	1,661,197
Change in unrealized gains on investments	147,302	(42,630)
Grant proceeds expended for equipment	(5,085)	(207,883)
Changes in operating assets and liabilities:		
Patient accounts receivable	(3,167,095)	(1,942,839)
Inventories	(11,986)	(69,555)
Prepaids and other	(141,836)	(145,295)
Accounts payable	14,500	119,001
Accrued liabilities	248,638	195,889
Estimated third-party settlements	(219,748)	(1,098,912)
Net cash provided by operating activities	2,103,066	1,302,350
INVESTING ACTIVITIES		
Change in assets limited as to use	(446,418)	(315,309)
Purchases of property and equipment	(1,033,078)	(955,669)
Purchases of investments	(18,917)	(17,697)
Net cash used in investing activities	(1,498,413)	(1,288,675)
FINANCING ACTIVITIES		
Principal payments on long-term debt	(840,363)	(844,405)
Grant proceeds expended for equipment	5,085	207,883
Net cash used in financing activities	(835,278)	(636,522)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(230,625)	(622,847)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	2,551,050	3,173,897
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 2,320,425	$ 2,551,050
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 599,185	$ 645,435

See notes to financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — Arkansas Valley Regional Medical Center (the Medical Center) operates as an acute-care hospital and long-term care nursing home in La Junta, Colorado. The Medical Center primarily earns revenues by providing inpatient, outpatient, and emergency care services for residents in Otero County, Colorado.

Use of Estimates — The preparation of financial statements in conformity with generally accepted accounting principles 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents — Cash and cash equivalents include highly liquid investments, other than those limited as to use, with original maturities of three months or less.

Patient Accounts Receivable — The Medical Center reports patient accounts receivable for services rendered at net realizable amounts from third-party payors, patients, and others. The Medical Center provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Medical Center bills third-party payors directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Inventories — Inventories are stated at lower of cost (first-in, first-out) or market.

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

Assets Limited as to Use — Assets limited as to use primarily include assets held by trustees under indenture agreements and designated assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the Medical Center have been included in current assets.

Property and Equipment — Property and equipment acquisitions in excess of $1,500 are capitalized and recorded at cost. Depreciation is computed using the straight-line method over estimated useful lives which range from 5 through 15 years for land improvements, 15 through 40 years for buildings and leasehold improvements, and 5 through 20 years for equipment. Assets under capital lease obligations and leasehold improvements are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life.

Donations of long-lived assets such as land, buildings, or equipment are reported as unrestricted assets, and are excluded from the excess of revenues over expenses, unless explicit donor restrictions specify how the donated assets must be used. Monetary gifts that must be used to acquire property and equipment are reported as restricted. Expiration of restrictions is reported as an increase in unrestricted net assets when the donated asset is placed into service.

Deferred Financing Costs — Financing costs incurred in connection with the issuance of bonds are deferred and amortized over the life of the bonds. Accumulated amortization totaled approximately $50,000 and $39,000 as of March 31, 2008 and 2007, respectively.

Temporarily and Permanently Restricted Net Assets — Temporarily restricted net assets are those whose use by the Medical Center 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 Medical Center in perpetuity. At March 31, 2008 and 2007, the Medical Center did not have any permanently or temporarily restricted net assets.

Excess of Revenues over Expenses — The statement of operations includes excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Net Patient Service Revenue — The Medical Center has agreements with third-party payors that provide for payments to the Medical Center 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 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 such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

Charity Care — The Medical Center provides care to patients who meet certain criteria under its charity care policy at amounts less than its established rates. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Donor-restricted Gifts — Unconditional promises to give cash and other assets are accrued at estimated fair value at the date each promise is received. The gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit their use. 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 as an increase in unrestricted net assets. Donor-restricted gifts whose stipulations are met within the same year as received are reported as unrestricted contributions.

Risk Management — The Medical Center is exposed to various risks of loss from torts, theft of, damage to and destruction of assets; business interruption; errors and omissions; natural disasters; and employee health, dental 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 preceding years. The provision for estimated medical malpractice claims, if any, includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Income Taxes — The Medical Center is organized as a Colorado non-profit corporation and has been recognized by the Internal Revenue Service as exempt from income taxes under Internal Revenue Code Section 501(c)(3). However, the Medical Center is subject to Federal income tax on any unrelated business taxable income.

Reclassifications — Certain reclassifications have been made to the 2006 financial statements to conform to the 2007 financial statement presentation.

2. INVESTMENTS

Investments — Investments of $406,482 and $387,565 as of March 31, 2008 and 2007, respectively, consist of certificates of deposit.

Assets Limited as to Use — Assets limited as to use consist of the following as of March 31, 2008 and 2007:

	2008	2007
Internally designated for capital improvements:		
U.S. Government obligations	$ 3,741,997	$ 2,301,863
Cash equivalents	1,554,580	2,634,902
Equity securities	1,370,987	1,490,364
Certificates of deposit	211,311	205,746
Total	$ 6,878,875	$ 6,632,875
Held by trustee for debt service:		
Cash equivalents	$ 1,658,689	$ 1,614,258
Deferred interest income	(138,960)	(147,645)
Total	1,519,729	1,466,613
Less current portion	671,042	651,876
Long-term portion	$ 848,687	$ 814,737

Investment Income — Investment income consists of the following for the years ended March 31, 2008 and 2007:

	2008	2007
Interest and dividend income	$ 208,359	$ 163,258
Realized gains on sales of investment securities	405,731	305,795
Total	$ 614,090	$ 469,053

3. NET PATIENT SERVICE REVENUE

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

Medicare and Medicaid — Medicare services are paid based on prospectively determined amounts. The Medical Center'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 Medical Center.

Inpatient services rendered to Medicaid program beneficiaries are reimbursed at a prospectively determined rate. Outpatient services are reimbursed under a cost reimbursement methodology.

Revenue from the Medicare program accounted for approximately 28% and 29%, respectively, of the Medical Center's net patient service revenue for the year ended March 31, 2008 and 2007. Revenue from the Medicaid program accounted for approximately 19% of the Medical Center's net patient service revenue for each of the years ended March 31, 2008 and 2007. Laws and regulations governing the Medicare and Medicaid programs are 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.

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

A summary of patient service revenue and contractual adjustments for the years ended March 31, 2008 and 2007 is as follows:

	2008	**2007**
Total patient service revenue	$ 61,736,068	$ 55,052,187
Contractual adjustments:		
Medicare and Medicaid	22,251,440	19,127,063
Other	5,250,116	2,978,173
Total contractual adjustments	27,501,556	22,105,236
Net patient service revenue	$ 34,234,512	$ 32,946,951

The 2008 net patient service revenue amount increased by $239,895 due to prior year settlements and changes in estimates of prior year settlement amounts.

4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable consist of the following as of March 31, 2008 and 2007:

	2008	2007
Patient accounts receivable	$ 9,963,876	$ 8,091,184
Less allowance for contractual adjustments	2,630,510	2,145,204
	7,333,366	5,945,980
Less allowance for uncollectible accounts	1,829,718	1,172,554
Patient accounts receivable — net	$ 5,503,648	$ 4,773,426

5. PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of March 31, 2008 and 2007:

	2008	2007
Buildings and leasehold improvements	$ 27,834,910	$ 27,643,758
Equipment	19,703,266	18,993,308
Land and land improvements	665,691	665,691
Construction in progress	189,661	55,932
Total	48,393,528	47,358,689
Less accumulated depreciation	24,052,776	21,915,018
Property and equipment — net	$ 24,340,752	$ 25,443,671

The City of La Junta and the Mennonite Board of Missions have a joint lien on the premises and real property of the Medical Center in the event such real property is sold. The lien expires on December 31, 2096.

6. LONG-TERM DEBT

Long-term debt consists of the following at March 31, 2008 and 2007:

	2008	2007
Hospital revenue bonds, maturing serially at varying amounts until April, 2024, annual sinking fund payments range from $513,319 to $889,020, interest is due in semi-annual interest payments at rates ranging from 4.40% to 6.10%, secured by revenues	$ 9,280,000	$ 9,600,000
Note payable to a financial institution, due in monthly installments of $31,188 including interest at 3.95%, due February 2010, secured by equipment	630,989	942,197

Note payable to a financial institution, due in monthly installments of $16,965 including interest at 4.38%, due September 2008, secured by equipment	117,068	315,179
Capital lease obligation to a financial institution, interest at 8%, collateralized by equipment, repaid in 2008.		11,044
Original issue discount	(84,063)	(89,158)
Total debt	9,943,994	10,779,262
Less current maturities	801,661	863,291
Long-term debt	$ 9,142,333	$ 9,915,971

Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows as of March 31, 2008:

Years ending March 31,

2009	$ 801,661
2010	626,520
2011	370,062
2012	390,062
2013	410,062
Thereafter	7,345,627
Total	$ 9,943,994

7. PENSION PLAN

The Medical Center sponsors a 401(k) plan. The plan covers all employees who have at least one year of service with a minimum of 1,000 hours. Contributions up to 15% of annual contributions may be made by employees. The Board of Directors of the Medical Center determines matching contributions and eligible profit sharing contributions annually. Medical Center contributions to the plan for the years ended March 31, 2008 and 2007 amounted to approximately $332,000 and $339,000, respectively.

8. CONCENTRATIONS OF RISK

The Medical Center grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of net patient accounts receivable as of March 31, 2008 and 2007 was as follows:

	2008	**2007**
Medicare	39 %	27 %
Medicaid	10 %	11 %
Other third-party payors	34 %	37 %
Patients	17 %	25 %
Total	100 %	100 %

The Medical Center maintains deposits in financial institutions, and these deposits from time to time exceed federally insured limits.

9. FUNCTIONAL EXPENSES

The Medical Center provides general health care services to residents within its geographic locations including pediatric care, cardiac, intensive care and outpatient surgery. Expenses related to providing these services by functional class for the years ended March 31, 2008 and 2007 are as follows:

	2008	**2007**
Health care services	$ 27,356,293	$ 26,416,078
General and administrative	6,987,915	6,840,412
Total	$ 34,344,208	$ 33,256,490

10. SELF-INSURED HEALTH CARE PLAN

The Medical Center sponsors a health care plan for its employees. This plan is self-insured to the extent of the deductible amounts under the excess risk insurance policy ($75,000 per occurrence and $1,000,000 aggregate) the Medical Center has obtained. Accruals for unpaid claims amounted to approximately $384,000 and $303,000 at March 31, 2008 and 2007, respectively, and are included in the accompanying balance sheets.

11. CHARITY CARE

The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. The amounts of charges foregone, based on established rates and net of Colorado Indigent Care Program payments, were approximately $1,687,000 and $394,000, for the years ended March 31, 2008 and 2007, respectively

12. COMMITMENTS AND CONTINGENCIES

The Medical Center purchases medical malpractice insurance under a claims-made policy. Under such policy, only claims made and reported to the insurer are covered during the policy term, regardless of when the incident giving rise to the claim occurred. The policy covers all claims that exceed the base policy amounts. The Medical Center is unaware of any claims or incidents that might give rise to a malpractice claim that is not covered by medical malpractice insurance.

The health care industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations, specifically those relating to Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously, billed and collected revenues from patient services. Management believes that the Medical Center is in substantial compliance with current laws and regulations.

13. CONSOLIDATION AGREEMENT FINANCIAL COVENANTS

The Medical Center is required to meet certain covenants pursuant to the consolidation agreement between the City, Mennonite Board of Missions and the Medical Center. The Medical Center was in compliance with such covenants as of March 31, 2008.