

# Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other				Local Unit Name		County	
Fiscal Year End		Opinion Date		Date Audit Report Submitted to State			

We affirm that:

We are certified public accountants licensed to practice in Michigan.

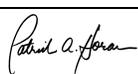
We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

**YES NO Check each applicable box below.** (See instructions for further detail.)

1.   All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2.   There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3.   The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4.   The local unit has adopted a budget for all required funds.
5.   A public hearing on the budget was held in accordance with State statute.
6.   The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7.   The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8.   The local unit only holds deposits/investments that comply with statutory requirements.
9.   The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10.   There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11.   The local unit is free of repeated comments from previous years.
12.   The audit opinion is UNQUALIFIED.
13.   The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14.   The board or council approves all invoices prior to payment as required by charter or statute.
15.   To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

<b>We have enclosed the following:</b>	Enclosed	Not Required (enter a brief justification)
Financial Statements	<input type="checkbox"/>	
The letter of Comments and Recommendations	<input type="checkbox"/>	
Other (Describe)	<input type="checkbox"/>	
Certified Public Accountant (Firm Name)		Telephone Number
Street Address	City	State      Zip
Authorizing CPA Signature 	Printed Name	License Number

# **Sturgis Hospital and Related Entities**

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**Combined Financial Report  
with Additional Information  
September 30, 2007**

# **Sturgis Hospital and Related Entities**

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## Independent Auditor's Report

To the Board of Directors  
Sturgis Hospital and Related Entities

We have audited the accompanying combined balance sheet of Sturgis Hospital and Related Entities (component units of the City of Sturgis, Michigan) (the "Hospital") as of September 30, 2007 and 2006 and the related combined statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined 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 combined financial statements referred to above present fairly, in all material respects, the combined financial position of Sturgis Hospital and Related Entities at September 30, 2007 and 2006 and the combined results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis is presented for the purpose of additional analysis as required by the Governmental Accounting Standards Board and is not a required part of the basic financial statements of Sturgis Hospital and Related Entities. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

*Plante & Moran, PLLC*

November 2, 2007

# **Sturgis Hospital and Related Entities**

## **Management's Discussion and Analysis**

Our discussion and analysis of Sturgis Hospital and Related Entities' (the "Hospital") financial performance provides an overview of the Hospital's financial activities for the fiscal years ended September 30, 2007 and 2006. Please read it in conjunction with the Hospital's financial statements, which begin on page 8.

### **Financial Highlights**

- The Hospital's net assets increased \$124,765 in 2006 then decreased \$99,888 in 2007.
- The Hospital reported operating losses in both 2006 (\$327,119) and 2007 (\$1,724,849). The operating results for 2007 decreased by \$1,397,730, or 427 percent over the operating results reported in 2006. Operating results in 2006 decreased by \$1,083,960, or 143 percent over the operating results reported in 2005.
- Nonoperating revenue increased in 2007 by \$1,173,077, or 260 percent compared to 2006. Nonoperating revenue decreased in 2006 by \$802,764, or 64 percent compared to 2005.

### **Using this Annual Report**

The combined financial statements consist of three statements: (a) a balance sheet, (b) a statement of revenues, expenses, and changes in net assets, and (c) a statement of cash flows. These combined financial statements and related notes provide information about the activities of the following:

- Sturgis Hospital, a component unit of the City of Sturgis
- Grobhiser medical office building, a blended component unit of the City of Sturgis
- The Foundation, a department of the Hospital.

The collection of financial activities identified above is referred to as the "Hospital."

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

One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better off or worse off as a result of the year's activities?" The balance sheet and statements of revenue, expenses, and changes in net assets report information on the Hospital as a whole and on its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

# Sturgis Hospital and Related Entities

## Management's Discussion and Analysis (Continued)

These two statements report the Hospital's net assets and changes in them. You can think of the Hospital's net assets - the difference between assets and liabilities - as one way to measure the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measure of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Hospital.

### The Statement of Cash Flows

The final required statement is the consolidated statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as, "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?"

### The Net Assets

The following is a comparative analysis of the major components of the statement of net assets of the Hospital as of September 30, 2007:

	September 30		Change	
	2007	2006	Amount	Percent
<b>Assets</b>				
Current assets	\$13,017,470	\$9,939,410	\$3,078,060	30.97%
Noncurrent assets	952,675	3,919,411	(2,966,736)	-75.69%
Capital assets	20,630,674	21,087,833	(457,159)	-2.17%
Total assets	<u>\$34,600,819</u>	<u>\$34,946,654</u>	<u>\$(345,835)</u>	<u>-0.99%</u>
<b>Liabilities</b>				
Current liabilities	\$5,901,763	\$5,592,916	\$308,847	5.52%
Long-term liabilities	11,689,636	12,244,430	(554,794)	-4.53%
Total liabilities	<u>\$17,591,399</u>	<u>\$17,837,346</u>	<u>\$(245,947)</u>	<u>-1.38%</u>
<b>Net Assets</b>				
Invested in capital assets - Net of related debt	\$8,536,277	\$8,424,925	\$111,352	1.32%
Unrestricted	8,465,796	8,143,778	322,018	3.95%
Restricted for specific purpose	7,347	540,605	(533,258)	-98.64%
Total net assets	<u>\$17,009,420</u>	<u>\$17,109,308</u>	<u>(\$99,888)</u>	<u>-0.58%</u>

The Hospital's net assets decreased in 2007 and increased in 2006 by minor amounts. However, fluctuations between current and noncurrent assets were significant. A shifting from long-term investments to short-term investments relates to the maturity cycle of the portfolio held during 2007.

# Sturgis Hospital and Related Entities

## Management's Discussion and Analysis (Continued)

### Operating Results for the Year

	2007	2006	Change	
			Amount	Percent
<b>Operating Revenue</b>				
Net patient service revenue	\$37,236,828	\$36,609,444	\$627,384	1.7%
Other operating revenue	331,358	402,867	(71,509)	-17.8%
Total operating revenue	37,568,186	37,012,311	555,875	1.5%
<b>Operating Expenses</b>				
Salaries and wages	15,815,092	14,971,330	843,762	5.6%
Benefits	6,272,806	6,404,404	(131,598)	-2.1%
Fees	5,253,686	4,892,232	361,454	7.4%
Supplies	5,583,448	5,532,760	50,688	0.9%
Purchased services	1,110,562	963,674	146,888	15.2%
Other expense	1,998,440	1,790,420	208,020	11.6%
Utilities	921,594	806,408	115,186	14.3%
Insurance	769,811	698,004	71,807	10.3%
Depreciation/Amortization	1,567,596	1,280,198	287,398	22.4%
Total operating expense	39,293,035	37,339,430	1,953,605	5.2%
<b>Operating Loss</b>	(1,724,849)	(327,119)	(1,397,730)	427.3%
<b>Nonoperating Revenue - Net</b>	1,624,961	451,884	1,173,077	259.6%
<b>Increase (Decrease) in Net Assets</b>	<b>\$(99,888)</b>	<b>\$124,765</b>	<b>\$(224,653)</b>	<b>-180.1%</b>

### Operating Losses

The first component of the overall change in the Hospital's net assets is its operating income (loss), generally the difference between net patient service revenue and the expenses incurred to perform those services. Net patient revenue includes patient service revenue less deductions from revenue. Deductions from revenue includes amounts written off related to contractual discounts given to third parties, charity care provided to indigent patients, and bad debts expenses related to uncollectible patient balances. In each of the past two years, the Hospital has reported an operating loss. In 2005, the Hospital reported operating income of \$756,841. The gradual deterioration of operations began in 2006 and increased significantly in 2007. The primary components of these increased operating losses are:

- A decrease in patient visits (inpatient and outpatient) of 4,050, or 4.4 percent in 2006. An increase in contractual discounts given to third parties of approximately \$4.2 million, or 14.0 percent in 2006. Both the patient volume and the increase in contractual discounts contributed to an overall decrease in net patient revenue of approximately \$2.0 million, or 5.3 percent in 2006.

# Sturgis Hospital and Related Entities

## Management's Discussion and Analysis (Continued)

- A modest increase in patient visits of 1,850, or 2.0 percent in 2007. Increases in charity care provided to indigent patients of approximately \$212,000, or 43 percent and increases in bad debts of approximately \$398,000, or 17 percent in 2007.
- Decreases in operating expenses of \$971,572 and 2.5 percent in 2006
- Increases in salaries and wages of \$843,762 or 5.6 percent in 2007
- Increases in fees and purchased services of \$361,454, or 7.4 percent in 2007
- Increase in depreciation of \$287,398, or 22.4 percent in 2007

Declines in patient volumes in 2006 were compounded with a shift in our patient mix and a shift in our patient service lines. The increase in the volume of patient revenue represented by Medicare, Medicaid, and Blue Cross (fixed payers) contributed to higher contractual discounts in 2006. Medicare is a program for the elderly and Medicaid is a program for the indigent and Blue Cross is a carrier with significant market influence. The discounts required by the fixed payers are much higher than discounts provided to commercial patients. In addition, the discount rate for the fixed payers increased as a result of a shift from lower discount surgical services to higher discount medical services. This trend was much more significant in 2006 than in 2007. However, the downturn of our local economy during 2007 contributed to higher charity care amounts and bad debt write-offs and discounts related to increases in the number of Medicaid patients.

Staffing reductions, decreases in insurance (malpractice and property), and reductions in fees for physical therapy and anesthesiology contributed to the \$971,572 decrease in operating expenses in 2006. The physical therapy volume and anesthesiology expenses decreased as a result of our shift in patient services from surgical to medical during 2006.

The 2007 increases in salaries and wages of \$843,762 relates principally to the successful recruitment of physicians, increases in physicians compensation related to increases in volumes, and expansion of pharmacist availability. We recruited two internal medicine physicians and an anesthesiologist, who became employees during 2007. Two other physicians' volume increased, thus, increasing their incentive-based pay by a total of \$200,000.

We experienced an increase in the fees and purchased services as a result of the use of contract agency nurses during 2007, an increase in physical therapy professional fees, and increases in physician contract fees for professional services.

Our investment in the physical plant of approximately \$15 million during 2005 and 2006 yielded increases in depreciation expense during 2007 as the building addition and contents were put into use during June 2006.

# Sturgis Hospital and Related Entities

## Management's Discussion and Analysis (Continued)

### Nonoperating Revenue - Net

The increase in the nonoperating revenue of \$1,173,077 during 2007 relates principally to the sale of 10 bed licenses to another healthcare organization. This bed sale renders the count of the licensed beds to 84 for Sturgis Hospital. The average daily census during any of the past 10 years has not exceeded 50. The average daily census for 2006 and 2007 was 17.5 and 17.8, respectively. The bed sale does not jeopardize future growth plans for the Hospital.

### Statement of Cash Flows

Another way to assess the financial health of a Hospital is to look at the statement of cash flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The statement of cash flows also helps assess the following:

- An entity's ability to generate future net cash flows
- Its ability to meet its obligations as they come due
- Its needs for external financing

	2007	2006	Increase (Decrease)
Cash provided by (used in):			
Operating activities	\$341,304	\$(1,697,370)	\$2,038,674
Capital and related financing activities	(173,730)	(9,132,446)	8,958,716
Investing activities	1,397,813	8,418,450	(5,350,265)
Net increase (decrease) in cash	1,565,387	(2,411,366)	5,647,125
Cash - Beginning of year	2,654,857	5,066,223	(2,411,366)
Cash - End of year	<b>\$4,220,244</b>	<b>\$2,654,857</b>	<b>\$3,235,759</b>

As indicated in the table above, the use of cash for operating activities during 2006 relates principally to a build of the patient accounts receivable and a decrease in the payable to third parties for cost report settlements. Conversely, the cash provided by operating activities during 2007 relates to an increase in the payable to third parties for cost report settlements. These fluctuations between years are difficult to predict and can be a matter of timing of audits related to the cost reports.

The use of cash for capital and related financing relates to the completion of the expansion project mentioned above. The liquidation of investments during 2006 occurred to pay for the expansion during 2006. The increase in cash from investing activities during 2007 relates to a shift from a longer lived investment portfolio to a shorter position. This shift is a matter of timing of maturities related to invested assets.

# Sturgis Hospital and Related Entities

## Management's Discussion and Analysis (Continued)

### Capital Asset and Debt Administration

#### Capital Assets

At September 30, 2007, the Hospital had approximately \$42.5 million invested in capital assets, and accumulated depreciation of \$21.9 million. Depreciation and amortization totaled approximately \$1.6 million for the 2007 compared to \$1.3 million for 2006. Details of these assets for the past two years are shown below:

	2007	2006	Increase
Land and improvements	\$495,850	\$492,850	\$3,000
Buildings and improvements	24,808,230	24,050,192	758,038
Furniture, fixtures, and equipment	17,159,269	16,886,183	273,086
Construction in progress	61,657	0	61,657
Total	<b>\$42,525,006</b>	<b>\$41,429,225</b>	<b>\$1,095,781</b>

#### Debt

At year end 2007, the Hospital had \$12.1 million of loans and notes as compared to \$12.7 million the previous year.

The Hospital paid down approximately \$568,000 during 2007, in alignment with its prescribed debt schedules. More detailed information about the Hospital's long-term liabilities is presented in the notes to the combined financial statements.

#### Economic Factors

The economic position of the Hospital is closely tied to that of the local economy. Because of limited economic growth and increased demand for resources where reimbursement is limited by federal and state mandates, the Hospital continues to look at cost containment measures. However, there have been many investments made during both 2006 and 2007 in the physical plant and the medical staff which management believes will position the Hospital well for the future.

#### Contacting the Hospital's Financial Management

The financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital's chief financial officer, Connie S. Downs, 916 Myrtle Avenue, Sturgis, Michigan 49091.

# Sturgis Hospital and Related Entities

## Combined Balance Sheet

	September 30, 2007	September 30, 2006
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents (Note 2)	\$ 4,143,269	\$ 2,406,367
Accounts receivable (Note 4)	5,697,349	5,647,441
Assets limited as to use (Notes 2 and 3)	1,747,347	248,490
Other current assets	1,429,505	1,637,112
Total current assets	13,017,470	9,939,410
<b>Property and Equipment - Net (Note 5)</b>	20,630,674	21,087,833
<b>Other Assets</b>		
Bond issue costs	677,151	701,483
Long-term investments (Note 2)	76,975	2,916,407
Other noncurrent assets	198,549	301,521
Total assets	<b>\$ 34,600,819</b>	<b>\$ 34,946,654</b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Current portion of long-term debt (Note 8)	\$ 404,761	\$ 418,478
Accounts payable	1,546,946	1,395,612
Estimated third-party payor settlements (Note 7)	1,607,449	403,621
Retainage payable	-	856,647
Accrued liabilities and other (Note 6)	2,342,607	2,518,558
Total current liabilities	5,901,763	5,592,916
<b>Long-term Debt - Net of current portion (Note 8)</b>	11,689,636	12,244,430
Total liabilities	17,591,399	17,837,346
<b>Net Assets</b>		
Invested in capital assets - Net of related debt	8,536,277	8,424,925
Donor restricted for specific operating activities	7,347	540,605
Unrestricted	8,465,796	8,143,778
Total net assets	17,009,420	17,109,308
Total liabilities and net assets	<b>\$ 34,600,819</b>	<b>\$ 34,946,654</b>

# Sturgis Hospital and Related Entities

## Combined Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended	
	September 30, 2007	September 30, 2006
<b>Operating Revenues</b>		
Net patient service revenue - Net of provision for bad debts of \$2,730,198 in 2007 and \$2,333,396 in 2006	\$ 37,236,828	\$ 36,609,444
Other	331,358	402,867
Total operating revenues	37,568,186	37,012,311
<b>Operating Expenses</b>		
Salaries and wages	15,815,092	14,971,330
Employee benefits and payroll taxes	6,272,806	6,404,404
Operating supplies and expenses	5,583,448	5,532,760
Purchased services	1,110,562	963,674
Insurance	769,811	698,004
Utilities	921,594	806,408
Other	1,998,440	1,790,420
Fees	5,253,686	4,892,232
Depreciation and amortization	1,567,596	1,280,198
Total operating expenses	39,293,035	37,339,430
<b>Operating Loss</b>	(1,724,849)	(327,119)
<b>Other Income (Expense)</b>		
Interest income	228,753	310,171
(Loss) gain on sale of property	(5,597)	16,228
Gain on the sale of bed licenses	1,740,000	-
Contributions	175,974	435,248
Other income	78,184	26,200
Interest expense	(592,353)	(335,963)
Total other income	1,624,961	451,884
<b>(Decrease) Increase in Net Assets</b>	(99,888)	124,765
<b>Net Assets - Beginning of year</b>	17,109,308	16,984,543
<b>Net Assets - End of year</b>	<b>\$ 17,009,420</b>	<b>\$ 17,109,308</b>

# Sturgis Hospital and Related Entities

## Combined Statement of Cash Flows

	Year Ended	
	September 30, 2007	September 30, 2006
<b>Cash Flows from Operating and Nonoperating Activities</b>		
Cash received from patients and third-party payors	\$ 38,390,748	\$ 34,874,088
Cash payments to suppliers for services and goods	(38,380,802)	(36,974,325)
Other	331,358	402,867
Net cash provided by (used in) operating activities	341,304	(1,697,370)
<b>Cash Flows from Investing Activities</b>		
Investment income	228,753	310,171
Sale of investments - Net	1,169,060	8,108,279
Net cash provided by investing activities	1,397,813	8,418,450
<b>Cash Flows from Capital and Related Financing Activities</b>		
Acquisition and construction of capital assets	(1,104,399)	(8,799,055)
Sale of beds	1,740,000	-
Proceeds from sale of capital assets	-	20,940
Bond issue cost	-	(164,728)
Interest paid on long-term debt	(592,353)	(335,963)
Principal payments on notes payable	(568,511)	(323,641)
Other	351,533	470,001
Net cash used in capital and related financing activities	(173,730)	(9,132,446)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	1,565,387	(2,411,366)
<b>Cash and Cash Equivalents - Beginning of year</b>	2,654,857	5,066,223
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 4,220,244</b>	<b>\$ 2,654,857</b>
<b>Balance Sheet Classification of Cash</b>		
Current assets	\$ 4,143,269	\$ 2,406,367
Assets limited as to use	76,975	248,490
Total cash	<b>\$ 4,220,244</b>	<b>\$ 2,654,857</b>

# Sturgis Hospital and Related Entities

## Combined Statement of Cash Flows (Continued)

A reconciliation of operating loss to net cash from operating activities is as follows:

	Year Ended	
	September 30, 2007	September 30, 2006
<b>Cash Flows from Operating Activities</b>		
Operating loss	\$ (1,724,849)	\$ (327,119)
Adjustments to reconcile operating loss to net cash from operating activities:		
Depreciation and amortization	1,585,890	1,280,198
Provision for bad debts	2,730,198	2,333,396
Changes in assets and liabilities:		
Increase in patient accounts receivable	(2,780,106)	(3,478,360)
Decrease in other current assets	207,607	77,183
Decrease in accounts payable	(705,313)	(1,102,818)
(Decrease) increase in other accrued expenses	(175,951)	116,529
Increase (decrease) in third-party settlement payables	1,203,828	(596,379)
Net cash provided by (used in) operating activities	<u>\$ 341,304</u>	<u>\$ (1,697,370)</u>

Significant noncash investing, capital, and financing activities for 2007 and 2006 are as follows:

- During the year ended September 30, 2006, the Hospital entered into a capital lease agreement in the amount of \$78,000.

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note I - Nature of Business and Significant Accounting Policies

Sturgis Hospital (the "Hospital") is a short-term, acute-care facility providing inpatient, outpatient, and home healthcare services to the Sturgis, Michigan area. The Hospital is a component unit of the City of Sturgis (a municipal corporation). The accompanying combined financial statements include accounts of the Hospital, a blended component unit that holds rental properties (Grobheiser), and a department of the Hospital that is used to fund projects (the "Foundation"). Intercompany transactions and balances between the Hospital and the rental properties have been eliminated in the combination.

**Basis of Presentation** - The combined financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the business-type activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. The Hospital also applies the Financial Accounting Standards Board statements and interpretations to the extent that they do not conflict with or contradict GASB pronouncements.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of 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.

**Investments** - Investments are stated at fair value.

**Property and Equipment** - Property and equipment purchases are recorded at cost. Leased equipment under capital leases is capitalized at the net present value of future minimum lease payments or the fair market value of the equipment, whichever is less. Depreciation and amortization are charged to operations using the straight-line method over the estimated useful lives of the assets. Maintenance and repairs are charged to expense as incurred.

**Compensated Absences** - Paid time off is charged to operations when earned. Unused and earned benefits are recorded as a current liability in the combined financial statements.

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

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

**Operating Revenue and Expenses** - The combined statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with provided healthcare services - the Hospital's principal activity. Nonexchange revenue, including all donations and interest, are reported as nonoperating revenue. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

**Restricted Resources** - When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use unrestricted resources before restricted resources.

**Net Assets** - Net assets of the Hospital are classified in three components: (1) net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets, (2) net assets restricted by donor and contributors external to the Hospital, and (3) unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

**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 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.

**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.

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

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

**Assets Limited as to Use** - Assets limited as to use include assets temporarily restricted by the board and assets temporarily restricted by donors. Amounts required to meet current liabilities of the Hospital have been reclassified in the combined balance sheet.

**Bond Issuance Costs** - Bond issuance costs were incurred by the Hospital in connection with obtaining the debt to finance the construction project. These costs are amortized over the term of the related debt.

### Note 2 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. A local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

#### 2007

**Custodial Credit Risk of Bank Deposits** - Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. At September 30, 2007, the Hospital had \$5,504,195 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 2 - Deposits and Investments (Continued)

**Custodial Credit Risk of Investments** - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. At September 30, 2007, the following investment securities were held by a counterparty, not considered a financial institution:

Investment	Carrying Value	How Held
Linsco/Private ledger	\$ 449,138	Counterparty
Security benefit	141,067	Counterparty

**Interest Rate Risk** - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity. At September 30, 2007, the average maturities of investments are as follows:

Investment	Fair Value	Maturities
Commercial paper	\$ 217,355	11/16/07
Municipal bonds	51,850	08/01/2011
Municipal bonds	25,125	10/01/2009

**Credit Risk** - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital's investment policy also states that any investments in obligations of the State of Michigan or any of its political subdivisions must be rated as investment grade by at least one rating service. As of September 30, 2007, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Commercial paper	\$ 217,355	A-1 +	Standards & Poor's
Municipal bonds	51,850	AA	Standards & Poor's
Municipal bonds	25,125	AAA	Standards & Poor's

**Concentration of Credit Risk** - The Hospital's investment policy states that not more than 50 percent of the cash and investments the Hospital holds can be invested in commercial paper at any one time.

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 2 - Deposits and Investments (Continued)

#### 2006

**Custodial Credit Risk of Bank Deposits** - Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. At September 30, 2006, the Hospital had \$2,572,716 of bank deposits (certificates of deposit and checking and savings accounts) that were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

**Custodial Credit Risk of Investments** - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. At September 30, 2006, the following investment securities were held by a counterparty, not considered a financial institution:

<u>Investment</u>	<u>Carrying Value</u>	<u>How Held</u>
JP Morgan	\$ 221,073	Counterparty
Linsco/Private ledger	671,863	Counterparty
Security benefit	136,969	Counterparty

**Interest Rate Risk** - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity. At September 30, 2006, the average maturities of investments are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Maturities</u>
Commercial paper	\$ 542,129	11/14/06
Municipal bonds	50,440	5/1/12
Municipal bonds	52,460	8/1/11
Municipal bonds	25,250	10/1/09

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 2 - Deposits and Investments (Continued)

**Credit Risk** - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital's investment policy also states that any investments in obligations of the State of Michigan or any of its political subdivisions must be rated as investment grade by at least one rating service. As of September 30, 2006, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Corporate bonds	\$ 542,129	A	Standard & Poor's
Municipal bonds	50,440	AAA	Moody's
Municipal bonds	52,460	AA2	Moody's
Municipal bonds	25,250	AAA	Moody's

**Concentration of Credit Risk** - The Hospital has stated that not more than 50 percent of the cash and investments the Hospital holds can be invested in commercial paper at any one time. The policy goes on to state that not more than 25 percent of the cash and investments may be invested in one type of investment.

### Note 3 - Assets Limited as to Use

Assets limited as to use consist of the following:

	2007	2006
Cash and cash equivalents	\$ 76,975	\$ -
Investments	1,670,372	248,490
Total assets limited as to use	\$ 1,747,347	\$ 248,490

Assets limited as to use are expected to be used for the following:

Donor restricted for specific purpose	\$ 7,347	\$ 8,436
Restricted by board for future capital uses	1,740,000	-
Bond fund for principal and interest	-	240,054
Total assets limited as to use	\$ 1,747,347	\$ 248,490

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 4 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below as follows:

	<u>2007</u>	<u>2006</u>
Patient accounts receivable	\$ 11,471,349	\$ 10,895,441
Less:		
Allowance for uncollectible accounts	(1,405,000)	(1,487,000)
Allowance for contractual adjustments	<u>(4,369,000)</u>	<u>(3,761,000)</u>
Net patient accounts receivable	<u>\$ 5,697,349</u>	<u>\$ 5,647,441</u>

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:

	<u>Percent</u>	
	<u>2007</u>	<u>2006</u>
Medicare	29	34
Blue Cross/Blue Shield of Michigan	11	10
Medicaid	17	8
Commercial insurance and HMOs	13	18
Self-pay	<u>30</u>	<u>30</u>
Total	<u>100</u>	<u>100</u>

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 5 - Capital Assets

Costs of capital assets and related depreciable lives for September 30, 2007 are summarized below:

	2006	Additions	Transfers	Retirements	2007	Depreciable Life - Years
Land and land improvements	\$ 492,850	\$ 3,000	\$ -	\$ -	\$ 495,850	8-15
Building and improvements	18,597,980	758,038	-	-	19,356,018	15-40
Rental buildings and improvements	5,452,212	-	-	-	5,452,212	5-40
Furniture, fixtures, and equipment	16,886,183	281,704	-	(8,618)	17,159,269	5-20
Construction in progress	-	61,657	-	-	61,657	-
<b>Total</b>	<b>41,429,225</b>	<b>\$ 1,104,399</b>	<b>\$ -</b>	<b>\$ (8,618)</b>	<b>42,525,006</b>	
Less accumulated depreciation:						
Land and land improvements	235,582	\$ 9,870	\$ -	\$ -	245,452	
Building and improvements	4,421,250	627,229	-	-	5,048,479	
Rental buildings and improvements	2,699,012	130,645	-	-	2,829,657	
Furniture, fixtures, and equipment	12,985,548	793,814	-	(8,618)	13,770,744	
<b>Total</b>	<b>20,341,392</b>	<b>\$ 1,561,558</b>	<b>\$ -</b>	<b>\$ (8,618)</b>	<b>21,894,332</b>	
<b>Net carrying amount</b>	<b>\$ 21,087,833</b>				<b>\$ 20,630,674</b>	

Costs of capital assets and related depreciable lives for September 30, 2006 are summarized below:

	2005	Additions	Transfers	Retirements	2006	Depreciable Life - Years
Land and land improvements	\$ 492,850	\$ -	\$ -	\$ -	\$ 492,850	8-15
Buildings and improvements	5,824,467	7,117,742	5,661,826	(6,055)	18,597,980	15-40
Rental buildings and improvements	5,452,212	-	-	-	5,452,212	5-40
Furniture, fixtures, and equipment	14,942,418	1,759,313	316,399	(131,947)	16,886,183	5-20
Construction in progress	5,978,225	-	(5,978,225)	-	-	-
<b>Total</b>	<b>32,690,172</b>	<b>\$ 8,877,055</b>	<b>\$ -</b>	<b>\$ (138,002)</b>	<b>41,429,225</b>	
Less accumulated depreciation:						
Land and land improvements	225,861	\$ 9,721	\$ -	\$ -	235,582	
Buildings and improvements	4,008,389	416,333	-	(3,472)	4,421,250	
Rental buildings and improvements	2,568,168	130,844	-	-	2,699,012	
Furniture, fixtures, and equipment	12,389,539	717,275	-	(121,266)	12,985,548	
<b>Total</b>	<b>19,191,957</b>	<b>\$ 1,274,173</b>	<b>\$ -</b>	<b>\$ (124,738)</b>	<b>20,341,392</b>	
<b>Net carrying amount</b>	<b>\$ 13,498,215</b>				<b>\$ 21,087,833</b>	

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 6 - Accrued Liabilities

The details of accrued liabilities at September 30, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>
Payroll and related items	\$ 818,487	\$ 789,944
Compensated absences	1,057,047	1,021,541
Professional liability claims (Note 9)	49,758	43,509
Self-insurance health benefit liability (Note 9)	400,000	400,000
Interest	-	244,361
Other	<u>17,315</u>	<u>19,203</u>
Total accrued liabilities	<u>\$ 2,342,607</u>	<u>\$ 2,518,558</u>

### Note 7 - 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 70 percent of the Hospital's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs. 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. 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.

Cost report settlements result from the adjustment for interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material impact on the accompanying combined financial statements.

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 8 - Long-term Debt

Long-term liability activity for the year ended September 30, 2007 was as follows:

	2006	Current Year Additions	Current Year Reductions	2007	Amounts Due Within One Year
Bonds - 2004	\$ 10,000,000	\$ -	\$ (260,000)	\$ 9,740,000	\$ 140,000
Bonds - 2005	995,000	-	(30,000)	965,000	20,000
Memorial Health Systems note	377,000	-	(52,000)	325,000	52,000
Century Bank & Trust building loan	196,710	-	(12,274)	184,436	12,932
Century Bank & Trust equipment loan	12,193	-	(1,604)	10,589	1,669
Century Bank & Trust R&F Loan	290,891	-	(17,625)	273,266	18,379
City of Sturgis - Electric Fund	458,479	-	(26,969)	431,510	26,969
City of Sturgis - Electric Fund	147,034	-	(81,386)	65,648	65,648
City of Sturgis - Bonds	55,417	-	(35,000)	20,417	20,417
GE Financial healthcare loan (capital lease)	14,181	-	(9,851)	4,330	4,330
GE bone densitometer (capital lease)	59,669	-	(15,802)	43,867	16,417
Highland iCad SL 300 System (capital lease)	56,334	-	(26,000)	30,334	26,000
<b>Total long-term debt</b>	<b>\$ 12,662,908</b>	<b>\$ -</b>	<b>\$ (568,511)</b>	<b>\$ 12,094,397</b>	<b>\$ 404,761</b>

Long-term liability activity for the year ended September 30, 2006 was as follows:

	2005	Current Year Additions	Current Year Reductions	2006	Amounts Due Within One Year
Bonds - 2004	\$ 10,000,000	\$ -	\$ -	\$ 10,000,000	\$ 125,000
Bonds - 2005	995,000	-	-	995,000	15,000
Memorial Health Systems note	429,000	-	(52,000)	377,000	52,000
Century Bank & Trust building loan	208,370	-	(11,660)	196,710	12,274
Century Bank & Trust equipment loan	13,727	-	(1,534)	12,193	1,604
Century Bank & Trust R&F Loan	307,792	-	(16,901)	290,891	17,625
City of Sturgis - Electric Fund	485,448	-	(26,969)	458,479	26,969
City of Sturgis - Electric Fund	223,692	-	(76,658)	147,034	81,386
City of Sturgis - Bonds	87,500	-	(32,083)	55,417	35,000
GE Financial healthcare loan (capital lease)	23,311	-	(9,130)	14,181	9,851
GE Fetal Monitors loan (capital lease)	1,311	-	(1,311)	-	-
Sturgis Bank & Trust loan (capital lease)	58,521	-	(58,521)	-	-
GE bone densitometer (capital lease)	74,877	-	(15,208)	59,669	15,769
Highland iCad SL 300 System (capital lease)	-	78,000	(21,666)	56,334	26,000
<b>Total long-term debt</b>	<b>\$ 12,908,549</b>	<b>\$ 78,000</b>	<b>\$ (323,641)</b>	<b>\$ 12,662,908</b>	<b>\$ 418,478</b>

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 8 - Long-term Debt (Continued)

The details of long-term debt are summarized as follows:

- Sturgis Building Authority Michigan Building Authority Bonds, Series 2004, payable annually from \$140,000 due on October 1, 2008 to \$725,000 due on October 1, 2034, plus interest paid semiannually with rates ranging from 3.75 percent to 4.75 percent, are collateralized by Hospital assets.
- Sturgis Building Authority Michigan Building Authority Bonds, Series 2005, payable annually from \$20,000 due on October 1, 2008 to \$60,000 due on October 1, 2034, plus interest paid semiannually with rates ranging from 4.25 percent to 4.8 percent, are collateralized by Hospital assets.
- The Memorial Health System note bears interest at prime as of January 1 of the Hospital's fiscal year, is payable in monthly installments of \$4,333 plus interest, is collateralized by certain buildings, and is due in January 2009.
- The Century Bank & Trust building loan bears interest at 5.15 percent, is payable in monthly installments of \$1,843, including interest, is collateralized by certain buildings, and is due in full in August 2018.
- The Century Bank & Trust equipment loan bears interest at 4.5 percent, is payable in monthly installments of \$177, including interest, is collateralized by certain equipment, and is due in full in June 2013.
- The Century Bank & Trust R&F loan bears interest at 4.2 percent, is payable in monthly installments of \$2,459, including interest, is collateralized by certain equipment, and is due in full in June 2019.
- The City of Sturgis - Electrical Fund note is payable in monthly installments of \$2,247, plus interest at 6 percent, is due in full in September 2023, and is collateralized by improvements to rental office building.
- The City of Sturgis - Electrical Fund note is payable in monthly installments of \$7,333, including interest at 6 percent, is due in full in June 2008, and is collateralized by improvements to the rental office building.
- The City of Sturgis - Bonds, a loan from the City of Sturgis for repayment of bonds, are payable in monthly installments of \$6,402, including interest at 4.96 percent, are due in full in April 2008, and are collateralized by hospital revenue.
- The GE Financial healthcare loan is a capital lease obligation with monthly payments of \$883, including imputed interest of 7.62 percent, and is collateralized by equipment.

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 8 - Long-term Debt (Continued)

- The GE Financial Services loan is a capital lease obligation with monthly payments of \$1,492, including imputed interest of 4 percent, and is collateralized by equipment.
- The Highland Capital Corporation loan is a capital lease obligation with monthly payments of \$2,167, and is collateralized by equipment.

The following is a schedule by years of bond and notes payable, capital lease obligations, and principal and interest as of September 30, 2007:

Years Ending September 30	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2008	\$ 358,014	\$ 549,838	\$ 46,747	\$ 1,567
2009	283,493	533,654	21,433	802
2010	295,144	519,912	10,351	143
2011	306,650	498,560	-	-
2012	318,583	492,006	-	-
2013-2017	1,652,705	2,248,162	-	-
2018-2022	1,874,308	1,880,484	-	-
2023-2027	2,306,969	1,431,720	-	-
2028-2032	3,090,000	821,928	-	-
2033-2035	1,530,000	110,053	-	-
Total	<u>\$ 12,015,866</u>	<u>\$ 9,086,317</u>	<u>\$ 78,531</u>	<u>\$ 2,512</u>

### Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, employee injuries (workers' compensation), as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for malpractice and general liability claims and participates with the City of Sturgis for claims relating to workers' compensation; the Hospital is self-insured for medical benefits claims.

**Self-insured Health Benefits** - Changes in the estimated liability for the past two years were as follows:

	2007	2006
Estimated liability - Beginning of year	\$ 400,000	\$ 400,000
Estimated claims incurred, including changes in estimates	3,095,883	3,404,857
Claim payments	(3,095,883)	(3,404,857)
Estimated liability - End of year (Note 6)	<u>\$ 400,000</u>	<u>\$ 400,000</u>

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 9 - Risk Management (Continued)

**Malpractice** - The Hospital is insured against potential professional liability claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital must pay a deductible toward the cost of litigating or settling any asserted claims. In addition, the Hospital bears the risk of the ultimate costs of any individual claim exceeding the policy limits for claims asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

The Hospital has been named a defendant in several malpractice suits. At this time, it is premature to evaluate the likely outcomes, amounts of settlements, if any, or whether they could exceed the insurance coverage. Management intends to vigorously defend these suits and does not expect any unfavorable impacts. Accordingly, an accrual has been made in Note 6 of these combined financial statements for the deductible potentially payable by the Hospital on the malpractice suits for the years ended September 30, 2007 and 2006.

### Note 10 - Defined Benefit Pension Plan

**Plan Description** - The Hospital participates in the City of Sturgis Employees' Retirement System (the "System"), which is a multiemployer defined benefit pension plan administered by the City of Sturgis. This plan covers all employees of the City of Sturgis, including the Hospital, who normally work 1,000 hours or more a year. The System provides retirement, disability, and death benefits to plan members and their beneficiaries. At December 31, 2006, the date of the most recent actuarial valuation, Hospital membership consisted of 107 retirees and beneficiaries currently receiving benefits and 314 current active employees. The plan does not issue a separate financial report.

**Contributions** - Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. The funding policy provides for periodic employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings. There are no employee contributions.

# Sturgis Hospital and Related Entities

## Notes to Combined Financial Statements September 30, 2007 and 2006

### Note 10 - Defined Benefit Pension Plan (Continued)

**Annual Pension Costs** - For the year ended September 30, 2007, the City's annual pension cost for the plan was equal to the City's required and actual contribution. The Hospital's annual pension costs were \$1,340,837, \$1,301,067, and \$1,272,000 in 2007, 2006, and 2005, respectively. The annual required contribution was determined as part of an actuarial valuation at December 31, 2006, using the entry actual age cost method. Significant actuarial assumptions used include (a) a 7 percent investment rate of return, (b) projected salary increases of 5.0 percent to 17.5 percent per year, and (c) no cost of living adjustments. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a five-year period. The assets as of the valuation date were less than the accrued liabilities for all divisions. Due to the underfunding of the plan, it is anticipated that the contribution requirement will be increased in future years.

The following table sets forth the funded status and amounts for the defined benefit plan:

	2006	2005	2004
Actual pension cost (APC)	\$ 1,929,451	\$ 1,739,597	\$ 1,437,413
Percentage of APC contributed	102 %	118 %	94 %
Actuarial value of assets	\$ 50,053,659	\$ 47,369,804	\$ 45,968,634
Actuarial accrued liability (entry age)	\$ 53,867,915	\$ 50,314,340	\$ 47,243,463
Underfunded actuarial accrued liability	\$ (3,814,256)	\$ (2,944,536)	\$ (1,274,829)
Funded ratio	93 %	94 %	97 %
Covered payroll	\$ 19,202,376	\$ 18,671,016	\$ 19,515,461
Underfunded actuarial accrued liability as a percentage of covered payroll	(20)%	(16)%	(6)%

### Note 11 - Postemployment Healthcare Benefits

In addition to providing pension benefits, the Hospital provides healthcare benefits for retirees. Currently, 69 retirees meet those eligibility requirements. The Hospital is self-insured for retirees' medical benefit claims. The Hospital's net cost for providing retirees' healthcare benefits was \$596,853 and \$782,393 (after retirees' contributions of \$91,868 and \$87,753) for the years ended September 30, 2007 and 2006, respectively.

Subsequent to year end, the Hospital terminated the postemployment healthcare benefits offered effective January 1, 2008.

# **Sturgis Hospital and Related Entities**

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## **Notes to Combined Financial Statements September 30, 2007 and 2006**

### **Note 12 - Charity Care**

The amount of charges excluded from revenue under the Hospital's charity care policy were \$719,069 and \$504,398 for 2007 and 2006, respectively.

In addition, under arrangements with various governmental insurance programs, the Hospital provides significant care to the local indigent population for which reimbursement for services rendered is generally less than the cost of providing such services. As part of their obligation to the local communities, the Hospital also provides numerous other services that benefit the communities and are generally performed at no charge.

## **Additional Information**

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To the Board of Directors  
Sturgis Hospital and Related Entities

We have audited the combined financial statements of Sturgis Hospital and Related Entities as of September 30, 2007 and 2006. Our audits were made for the purpose of forming an opinion on the combined financial statements taken as a whole. The accompanying combining balance sheet and statement of revenues and expenses are presented for the purpose of additional analysis of the combined financial statements rather than to present the financial position and results of operations of the individual entities and are not required parts of the basic combined financial statements. The combining information has been subjected to the procedures applied in the audits of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

*Plante & Moran, PLLC*

November 2, 2007

# Sturgis Hospital and Related Entities

## Combining Balance Sheet September 30, 2007

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
<b>Assets</b>					
<b>Current Assets</b>					
Cash and cash equivalents	\$ 4,143,269	\$ -	\$ 141,158	\$ (141,158)	\$ 4,143,269
Accounts receivable	5,547,261	41,296	108,792	-	5,697,349
Notes and advances to affiliates	1,245,610	-	-	(1,245,610)	-
Assets limited as to use	1,747,347	-	-	-	1,747,347
Other current assets	1,281,238	7,109	-	141,158	1,429,505
Total current assets	13,964,725	48,405	249,950	(1,245,610)	13,017,470
<b>Property and Equipment - Net</b>	18,008,121	2,622,553	-	-	20,630,674
<b>Other Assets</b>					
Bond issue costs	677,151	-	-	-	677,151
Long-term investments	76,975	-	-	-	76,975
Other noncurrent assets	25,000	-	173,549	-	198,549
Total assets	<b>\$ 32,751,972</b>	<b>\$ 2,670,958</b>	<b>\$ 423,499</b>	<b>\$ (1,245,610)</b>	<b>\$ 34,600,819</b>
<b>Liabilities and Net Assets</b>					
<b>Current Liabilities</b>					
Current portion of long-term debt	\$ 291,726	\$ 113,035	\$ -	\$ -	\$ 404,761
Notes payable	-	1,245,610	-	(1,245,610)	-
Accounts payable	1,541,704	1,300	3,942	-	1,546,946
Estimated third-party payor settlements	1,607,449	-	-	-	1,607,449
Accrued liabilities and other	2,342,607	-	-	-	2,342,607
Total current liabilities	5,783,486	1,359,945	3,942	(1,245,610)	5,901,763
<b>Long-term Debt - Net of current portion</b>	11,285,096	404,540	-	-	11,689,636
Total liabilities	17,068,582	1,764,485	3,942	(1,245,610)	17,591,399
<b>Net Assets</b>					
Invested in capital assets - Net of related debt	6,431,299	2,104,978	-	-	8,536,277
Donor restricted for specific operating activities	7,347	-	-	-	7,347
Unrestricted	9,244,744	(1,198,505)	419,557	-	8,465,796
Total liabilities and net assets	<b>\$ 32,751,972</b>	<b>\$ 2,670,958</b>	<b>\$ 423,499</b>	<b>\$ (1,245,610)</b>	<b>\$ 34,600,819</b>

# Sturgis Hospital and Related Entities

## Combining Statement of Revenues and Expenses Year Ended September 30, 2007

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
<b>Operating Revenues</b>					
Net patient service revenue - Net of provision for bad debts	\$ 37,236,828	\$ -	\$ -	\$ -	\$ 37,236,828
Other	126,253	299,230	-	(94,125)	331,358
Total operating revenues	37,363,081	299,230	-	(94,125)	37,568,186
<b>Operating Expenses</b>					
Salaries and wages	15,815,092	-	-	-	15,815,092
Employee benefits and payroll taxes	6,272,806	-	-	-	6,272,806
Operating supplies and expenses	5,581,786	1,662	-	-	5,583,448
Purchased services	1,089,549	21,013	-	-	1,110,562
Insurance	765,728	4,083	-	-	769,811
Utilities	811,050	110,544	-	-	921,594
Other	2,086,565	-	-	(88,125)	1,998,440
Fees	5,253,686	6,000	-	(6,000)	5,253,686
Depreciation and amortization	1,436,951	130,645	-	-	1,567,596
Total operating expenses	39,113,213	273,947	-	(94,125)	39,293,035
<b>Operating Income (Loss)</b>	(1,750,132)	25,283	-	-	(1,724,849)
<b>Other Income (Expense)</b>					
Interest income	228,753	-	-	-	228,753
Loss on sale of property	(5,597)	-	-	-	(5,597)
Gain on sale of beds	1,740,000	-	-	-	1,740,000
Contributions	288,586	-	109,250	(197,983)	199,853
Disbursements for specific purpose	-	-	(221,862)	197,983	(23,879)
Other income	78,184	-	-	-	78,184
Interest expense	(555,708)	(36,645)	-	-	(592,353)
Total other income (expense)	1,774,218	(36,645)	(112,612)	-	1,624,961
<b>Increase (Decrease) in Net Assets</b>	<b>\$ 24,086</b>	<b>\$ (11,362)</b>	<b>\$ (112,612)</b>	<b>\$ -</b>	<b>\$ (99,888)</b>