

# **Bell Memorial Hospital and Affiliate**

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**Combined Financial Report  
with Additional Information  
June 30, 2010**

# **Bell Memorial Hospital and Affiliate**

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Plante & Moran, PLLC  
Suite 100  
1111 Michigan Ave.  
East Lansing, MI 48823  
Tel: 517.332.6200  
Fax: 517.332.8502  
plantemoran.com

## Independent Auditor's Report

To the Board of Directors  
Bell Memorial Hospital and Affiliate

We have audited the accompanying combined balance sheet of Bell Memorial Hospital and Affiliate (the "Hospital") as of June 30, 2010 and 2009 and the related combined statements of operations, 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 combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined 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 Bell Memorial Hospital and Affiliate at June 30, 2010 and 2009 and the combined results of their 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*

March 28, 2011

# Bell Memorial Hospital and Affiliate

## Combined Balance Sheet

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 6,433,839	\$ 6,826,309
Accounts receivable (Note 2)	6,640,379	6,101,497
Estimated third-party payor settlements (Note 3)	622,791	2,287,100
Assets limited as to use (Note 5)	-	1,192,492
Inventory	1,651,534	1,364,370
Prepaid expenses and other	324,275	304,167
Total current assets	15,672,818	18,075,935
<b>Property and Equipment - Net (Note 4)</b>	45,787,031	46,571,864
<b>Other Assets (Note 5)</b>	4,359,485	4,784,936
Total assets	<u><u>\$ 65,819,334</u></u>	<u><u>\$ 69,432,735</u></u>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Current portion of long-term debt (Note 7)	\$ 1,014,827	\$ 948,861
Accounts payable	1,946,252	1,980,760
Estimated third-party payor settlements (Note 3)	1,648,228	-
Accrued liabilities	2,655,509	2,267,323
Total current liabilities	7,264,816	5,196,944
<b>Long-term Debt - Net of current portion (Note 7)</b>	33,357,707	34,298,294
<b>Other Liabilities (Note 9)</b>	8,140,401	6,350,737
Total liabilities	48,762,924	45,845,975
<b>Net Assets</b>		
Unrestricted	15,230,874	22,696,777
Temporarily restricted	1,825,536	889,983
Total net assets	17,056,410	23,586,760
Total liabilities and net assets	<u><u>\$ 65,819,334</u></u>	<u><u>\$ 69,432,735</u></u>

# Bell Memorial Hospital and Affiliate

## Combined Statement of Operations

	Year Ended	
	June 30, 2010	June 30, 2009
<b>Unrestricted Revenue, Gains, and Other Support</b>		
Net patient service revenue	\$ 47,347,313	\$ 51,436,064
Other	2,089,450	1,400,470
Net assets released from restrictions used for operations	-	650,000
Total unrestricted revenue, gains, and other support	49,436,763	53,486,534
<b>Expenses</b>		
Salaries and wages	23,750,876	23,082,283
Employee benefits	6,331,366	6,188,366
Supplies	6,109,957	7,264,987
Purchased services	2,720,210	3,090,919
Insurance	568,137	618,336
Other healthcare expenses	5,616,110	5,428,549
Depreciation and amortization (Note 4)	2,870,275	2,561,759
Provision for bad debts	6,505,285	3,672,521
Interest expense	1,996,168	1,372,640
Total expenses (Note 12)	56,468,384	53,280,360
<b>Operating (Loss) Income</b>	(7,031,621)	206,174
<b>Other Income (Expenses)</b>		
Investment income (Note 5)	402,991	14,217
Contributions	634,142	208,577
Net change in unrealized gains and losses on investments (Note 5)	286,954	(185,172)
Change in fair value of interest rate swap agreements (Note 8)	(849,572)	(1,045,268)
Total other income (expenses)	474,515	(1,007,646)
<b>Excess of Revenue Under Expenses Before Unusual Event</b>	(6,557,106)	(801,472)
<b>Unusual Event - Sale of old facility (Note 4)</b>	-	(75,000)
<b>Excess of Revenue Under Expenses</b>	(6,557,106)	(876,472)
<b>Pension-related Changes Other Than Net Periodic Pension Costs (Note 10)</b>	(908,797)	(1,950,755)
<b>Net Assets Released from Restrictions</b>	-	100,000
<b>Decrease in Unrestricted Net Assets</b>	<u>\$ (7,465,903)</u>	<u>\$ (2,727,227)</u>

# Bell Memorial Hospital and Affiliate

## Combined Statement of Changes in Net Assets

	Year Ended	
	June 30, 2010	June 30, 2009
<b>Unrestricted Net Assets</b>		
Excess of revenue under expenses	\$ (6,557,106)	\$ (876,472)
Pension-related changes other than net periodic pension costs	(908,797)	(1,950,755)
Net assets released from restriction	<u>-</u>	<u>100,000</u>
<b>Decrease in Unrestricted Net Assets</b>	<b>(7,465,903)</b>	<b>(2,727,227)</b>
<b>Temporarily Restricted Net Assets</b>		
Change in interest of net assets of charitable foundation	935,553	641,803
Net assets released from restrictions	<u>-</u>	<u>(750,000)</u>
<b>Increase (Decrease) in Temporarily Restricted Net Assets</b>	<b>935,553</b>	<b>(108,197)</b>
<b>Decrease in Net Assets</b>	<b>(6,530,350)</b>	<b>(2,835,424)</b>
<b>Net Assets - Beginning of year</b>	<b>23,586,760</b>	<b>26,422,184</b>
<b>Net Assets - End of year</b>	<b><u>\$ 17,056,410</u></b>	<b><u>\$ 23,586,760</u></b>

# Bell Memorial Hospital and Affiliate

## Combined Statement of Cash Flows

	Year Ended	
	June 30, 2010	June 30, 2009
<b>Cash Flows from Operating Activities</b>		
Decrease in net assets	\$ (6,530,350)	\$ (2,835,424)
Adjustments to reconcile decrease in net assets to net cash from operating activities:		
Depreciation and amortization	2,870,275	2,561,759
Net change in unrealized gains and losses on investments	(286,954)	185,172
Realized (gain) loss on sales of investments	(348,993)	206,525
Change in beneficial interest in net assets of Bell Foundation	(935,553)	(641,803)
Pension-related changes other than net periodic pension costs	908,797	1,950,755
Change in fair value of interest rate swap agreements	849,572	1,045,268
Unusual event - Conditional asset retirement obligation	-	75,000
Provision for bad debts	6,505,285	3,672,521
(Gain) loss on disposal of property and equipment	(38,349)	256,285
Changes in assets and liabilities which (used) provided cash:		
Accounts receivable	(7,101,512)	(5,719,152)
Estimated third-party payor settlements receivable	1,824,100	(1,054,196)
Inventory	(287,164)	126,550
Prepaid expenses and other	(20,108)	(58,587)
Other assets	-	108,197
Accounts payable	(34,508)	389,402
Estimated third-party payor settlements payable	1,545,782	-
Accrued liabilities	473,713	45,321
Other liabilities	31,295	3,577
Net cash (used in) provided by operating activities	(574,672)	317,170
<b>Cash Flows from Investing Activities</b>		
Purchase of property and equipment	(2,138,708)	(16,401,892)
Proceeds from sale of property and equipment	20,761	7,345
Purchase of investments held by trustee under self-insurance arrangements	(1,501,715)	(878,167)
Proceeds from sales of investments held by trustee under self-insurance arrangements	1,194,870	907,564
Purchase of investments held by trustees under bond indenture	(2,665,861)	(14,420,844)
Proceeds from sales of investments held by trustee under bond indenture	4,951,009	26,083,113
Collection of note receivable from affiliate	260,914	83,901
Net cash provided by (used in) investing activities	121,270	(4,618,980)
<b>Cash Flows from Financing Activities</b>		
Proceeds from the issuance of debt	105,979	-
Principal payments on long-term debt	(980,600)	(930,385)
Temporarily restricted contributions	935,553	641,803
Net cash provided by (used in) financing activities	60,932	(288,582)
<b>Net Decrease in Cash and Cash Equivalents</b>	(392,470)	(4,590,392)
<b>Cash and Cash Equivalents - Beginning of year</b>	6,826,309	11,416,701
<b>Cash and Cash Equivalents - End of year</b>	<u>\$ 6,433,839</u>	<u>\$ 6,826,309</u>
<b>Supplemental Cash Flow Information</b>		
Cash paid for interest	\$ 1,641,571	\$ 1,363,491
Abatement for future liability capitalized	-	75,000

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

### **Note 1 - Nature of Business and Significant Accounting Policies**

**Reporting Entity** - Bell Memorial Hospital (the "Hospital"), located in Ishpeming, Michigan, is a not-for-profit hospital. The Hospital provides inpatient and outpatient health care to residents of Ishpeming, Michigan and the surrounding communities. Admitting physicians are primarily practitioners in the local area. The Hospital's sole member is Superior Healthcare System, a Michigan nonprofit holding company. Bell Medical Center (the "Center") is a nonprofit corporation that operates physicians' offices providing services to patients and is located on the campus of Bell Memorial Hospital. The Center's sole member is Superior Healthcare System. The Hospital provides financial support for the operations of the Center and has the ability to determine direction and assign various healthcare-related functions to the Center.

A significant portion of the Hospital's and the Center's net patient service revenue is receivable under contractual arrangements with the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs.

**Principles of Combination** - The combined financial statements include the accounts of Bell Memorial Hospital and its affiliate, Bell Medical Center. Intercompany balances and transactions have been eliminated in combination.

**Cash and Cash Equivalents** - Cash and cash equivalents include temporary investments with a maturity of three months or less, excluding those amounts included in assets limited as to use (see Note 5). The Hospital maintains cash balances at several financial institutions. Accounts at each institution are insured by the FDIC up to \$250,000 per institution. As of June 30, 2010, the uninsured cash balances approximated \$7,271,000.

**Accounts Receivable** - Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical loss rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Hospital's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for uncollectible accounts in the period they are deemed to be uncollectible. The allowance for contractual adjustments is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

**Inventory** - Inventory, which consists primarily of medical and pharmaceutical products, is stated at the lower of cost, determined on a first-in, first-out basis, or market.



# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

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

**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. Interest cost incurred on borrowed funds during the period of construction of capital assets, net of income earned on those funds, is capitalized as a component of the cost of constructing those assets.

**Assets Limited as to Use** - Assets limited as to use labeled "held by trustee for payment of professional liability claims" are self-insurance funds restricted by the self-insurance trust agreement for funding professional liability claims of the Hospital. Assets limited as to use labeled "held by trustee under bond indenture" are bond proceeds restricted by the indenture agreement for funding future bond principal and interest payments and funding the replacement hospital facility (see Note 5).

**Investments** - Investments are stated at fair market value. Investment income or loss (including realized and changes in unrealized gains and losses on investments, interest, and dividends) is included in excess of revenue under expenses, unless the income or loss is restricted by the donor.

The Hospital's investments are all classified as trading, with unrealized gains and losses included in excess of revenue under expenses.

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the combined balance sheet.

**Interest in Net Assets of Charitable Foundation** - Interest in net assets of Bell Foundation (the "Foundation") reflects the future beneficial interests to be received by Bell Memorial Hospital for the construction of the replacement hospital. This interest in the future contributions from the Foundation is recorded at the fair market value of the assets in the Foundation specifically designated for the benefit of Bell Memorial Hospital and Affiliate.

**Debt Issuance Costs** - Debt issuance costs were incurred by the Hospital in connection with obtaining the Series 2007 and Series 2007B Bonds. These costs are amortized over the term of the related debt, commencing with the first bond principal payment made during the year ended June 30, 2009. Amortization expense totaled \$14,673 and \$20,077 for the years ended June 30, 2010 and 2009, respectively.

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

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

**Interest Rate Swap** - The Hospital entered into an interest rate swap agreement to reduce economic risks associated with variability in cash outflows for interest required under provisions of variable rate revenue bonds. Interest rate swaps are recognized as assets or liabilities at fair value. Realized gains and losses on interest rate swaps are classified as a component of operating income and are presented as part of interest expense in the combined statement of changes in net assets. Unrealized changes in the fair value of the interest rate swap are recognized as part of other income, separate from operating income (see Note 8). The Hospital does not use hedge accounting for these swaps.

**Professional Liability Insurance** - The Hospital accrues the estimated ultimate expense, including litigation and settlement expense, for any reported and unreported incidents of potential improper professional services during the year that are in excess of applicable insurance coverage or fall within the applicable deductible amounts (see Note 12).

**Temporarily Restricted Net Assets** - Temporarily restricted net assets reflect assets contributed or pledged to the Bell Foundation on behalf of the Hospital and/or its affiliate, the use of which is restricted by the donor. Temporarily restricted net assets are restricted for the replacement hospital facility project and related property and equipment purchases. Investment earnings on temporarily restricted investments are restricted by donors for specific purposes.

**Net Patient Service Revenue** - 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. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as 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. Charity care for the years ended June 30, 2010 and 2009 totaled approximately \$897,000 and \$402,000, respectively.

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

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

**Employee Pension Plan** - The Hospital maintains a defined contribution plan and a defined benefit plan. Eligibility separately for each plan is for qualified employees who meet certain requirements as to age and length of service as documented in each plan. Each employee's interest is vested as specified in the plans. For the defined contribution plan, pension expense is recognized as it is earned by the employees. For the defined benefit plan, pension expense is actuarially determined (see Note 11).

**Operating and Nonoperating Activities** - The Hospital's primary mission is to meet the healthcare needs of its local market area through a broad range of general and specialized healthcare services including inpatient acute care, outpatient services, and other healthcare services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses unrelated to the Hospital's primary mission are considered to be nonoperating and are reported in other income, consisting of unrestricted donations, investment income, realized and unrealized gains and losses on investments, and change in the fair value of the interest rate swap agreements.

**Excess of Revenue Under Expenses** - The combined statement of operations includes excess of revenue under expenses. Changes in unrestricted net assets, which are excluded from excess of revenue under expenses, consistent with industry practice, include contributions of long-lived assets and pension liability adjustments.

**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 combined statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying combined financial statements.

Gifts of long-lived assets such as land, buildings, and equipment are reported as unrestricted support unless explicit donor stipulations specify how donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and 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, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service. Donated long-lived assets are recorded at fair market value at the time of contribution.

# Bell Memorial Hospital and Affiliate

## Notes to Combined Financial Statements June 30, 2010 and 2009

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

**Tax Status** - The Hospital and the Center are tax exempt under Section 501(c)(3) of the Internal Revenue Code and, accordingly, no tax provision is reflected in the combined financial statements.

**Use of Estimates** - The preparation of combined 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 combined financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

**Fair Value of Financial Instruments** - The fair value of financial instruments, including cash, accounts receivable, accounts payable, interest rate swap agreements, and debt, approximates carrying values. Investments are recorded at fair value under generally accepted accounting principles. The fair value of debt approximates carrying value because of the variable rate nature of the instrument.

**Reclassification** - Certain 2009 amounts have been reclassified to conform to the 2010 presentation.

**Subsequent Events** - The combined financial statements and related disclosures include evaluation of events up through and including March 28, 2011, which is the date the combined financial statements were issued.

### Note 2 - Patient Accounts Receivable

Accounts receivable consist of the following:

	2010	2009
Patients, insurance companies, and governmental agencies	\$ 18,095,810	\$ 16,675,882
Less allowance for uncollectible accounts	(4,040,448)	(2,146,125)
Less allowance for contractual adjustments and interim payment advances	(7,635,336)	(8,653,482)
Total patient accounts receivable	6,420,026	5,876,275
Other	220,353	225,222
Total accounts receivable	<u>\$ 6,640,379</u>	<u>\$ 6,101,497</u>

# Bell Memorial Hospital and Affiliate

## Notes to Combined Financial Statements June 30, 2010 and 2009

### Note 2 - Patient Accounts Receivable (Continued)

The Hospital and its affiliate grant 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 is as follows:

	Percent	
	2010	2009
Medicare	29	31
Blue Cross/Blue Shield of Michigan	23	23
Medicaid	15	11
Commercial insurance and HMOs	10	18
Patients	23	17
Total	100	100

### Note 3 - Patient Service Revenue

Approximately 87 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 and its affiliate have agreements with third-party payors that provide for reimbursement at amounts different from established rates. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - The Hospital is reimbursed as a critical access hospital by the Medicare program. Critical access hospitals receive cost reimbursement for all acute-care inpatient and most outpatient services. Other outpatient services are reimbursed on an established fee-for-service methodology.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Inpatient 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 or ambulatory payment classification system.
- **Blue Cross/Blue Shield of Michigan** - Services rendered to subscribers are reimbursed as a percentage of charges subject to a limitation on the annual rate of increase.

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

### **Note 3 - Patient Service Revenue (Continued)**

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs that are subject to audit by fiscal intermediaries. These audits may result in changes to these estimated cost report settlement balances and will be adjusted in future periods as final settlements are determined. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. There were no significant final cost report settlements impacting net patient service revenue for the year ended June 30, 2010 and the final cost report settlements increased net patient service revenue by approximately \$1,200,000 for the year ended June 30, 2009, reflecting the amount of settlements received for prior years in excess of previously estimated amounts.

The Medicare program has initiated a recovery audit contractor (RAC) initiative, whereby claims subsequent to October 1, 2007 will be reviewed by contractors for validity, accuracy, and proper documentation. A demonstration project completed in several other states resulted in the identification of potential significant overpayments. The Hospital has been contacted by the RAC auditors, and is currently unable to determine the extent of liability for overpayments, if any.

### **Note 4 - Property and Equipment**

The cost of property and equipment and depreciable lives are summarized as follows.

	<u>2010</u>	<u>2009</u>	<u>Depreciable Life - Years</u>
Land	\$ 2,229,995	\$ 2,217,184	-
Buildings and building improvements	39,782,554	40,048,421	20-40
Equipment	17,979,682	15,381,754	3-5
Construction in progress	<u>15,000</u>	<u>533,864</u>	-
Total cost	60,007,231	58,181,223	
Less accumulated depreciation	<u>(14,220,200)</u>	<u>(11,609,359)</u>	
Net carrying amount	<u>\$ 45,787,031</u>	<u>\$ 46,571,864</u>	

# Bell Memorial Hospital and Affiliate

## Notes to Combined Financial Statements June 30, 2010 and 2009

### Note 4 - Property and Equipment (Continued)

Depreciation expense on property, plant, and equipment totaled \$2,855,602 and \$2,541,682 in 2010 and 2009, respectively.

During 2009, the Hospital entered into an agreement with a local developer to sell its old facility for \$1. In connection with this agreement, the Hospital is obligated for an amount not to exceed \$825,000 for the removal of asbestos within the old facility. At June 30, 2010 and 2009, the total amount outstanding under this agreement totaled \$700,000 and \$825,000, respectively. This amount is payable in annual amounts totaling \$100,000, \$100,000, and \$500,000 during the years ending June 30, 2011, 2012, and 2013, respectively (see Note 9).

### Note 5 - Other Assets

Other assets consist of the following:

	2010	2009
Assets limited as to use:		
Funds held by trustees under bond indenture	\$ 3,336	\$ 2,536,022
By board of trustees for payment of professional liability claims	2,006,726	1,751,949
Total assets limited as to use	2,010,062	4,287,971
Less amount for payment of current liabilities	-	(1,192,492)
Total assets limited as to use - Long term	2,010,062	3,095,479
Beneficial interest in net assets of Bell Foundation	1,825,536	889,983
Bond issues costs - Net	266,549	281,222
Other	257,338	518,252
Total other assets	\$ 4,359,485	\$ 4,784,936

Investments consist of the following:

	2010	2009
Money market investments	\$ 67,431	\$ 2,589,234
Corporate bonds	577,754	479,769
Common and preferred stocks	1,364,877	1,218,968
Total	\$ 2,010,062	\$ 4,287,971

# Bell Memorial Hospital and Affiliate

## Notes to Combined Financial Statements June 30, 2010 and 2009

### Note 5 - Other Assets (Continued)

Investment income and change in net unrealized gains and losses on investments are reported in the combined statements of operations and changes in net assets as follows:

	2010	2009
Investment income - Interest and dividends	\$ 53,998	\$ 220,742
Investment income - Realized gain (loss) on sale of investments	348,993	(206,525)
Net change in unrealized gains and losses on investments	286,954	(185,172)
Total investment income (loss)	<u>\$ 689,945</u>	<u>\$ (170,955)</u>

### Note 6 - Fair Value

Accounting standards require certain assets and liabilities to be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the valuation techniques and inputs used to measure fair value.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Hospital has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances where inputs used to measure fair value fall into different levels of the fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Hospital's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

The Hospital measures money market investments, corporate bonds, and common and preferred stocks at fair value on a recurring basis. The fair value of these assets is based primarily on Level 1 inputs as described above.

The Hospital measures its interest rate swap agreement at fair value on a recurring basis. The fair value of this asset is based primarily on Level 2 inputs as described above.



## **Bell Memorial Hospital and Affiliate**

### **Notes to Combined Financial Statements June 30, 2010 and 2009**

#### **Note 7 - Long-term Debt**

Long-term debt at June 30, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Notes payable to Michigan State Hospital Finance Authority	\$ 170,355	\$ 306,639
Adjustable Rate Demand Limited Obligation Revenue Bonds, Series 2007	30,835,000	31,575,000
Adjustable Rate Demand Limited Obligation Revenue Bonds, Series 2007B	3,535,000	3,620,000
Other	<u>114,793</u>	<u>43,658</u>
Total	34,655,148	35,545,297
Less original issue discount	282,614	298,142
Less current portion	<u>1,014,827</u>	<u>948,861</u>
Long-term portion	<u>\$ 33,357,707</u>	<u>\$ 34,298,294</u>

The note payable to the Michigan State Hospital Finance Authority (MSHFA) is collateralized by an irrevocable bank letter of credit. This note is due in monthly installments of approximately \$11,000 through September 2011, plus interest due at a variable rate of 1.0 percent at June 30, 2010 (2.5 percent at June 30, 2009). The letter of credit expires in conjunction with the final installment in September 2011.

The Adjustable Rate Demand Limited Obligation Revenue Bonds, Series 2007 and Series 2007B, issued by the Economic Development Corporation of the County of Marquette, Michigan, were issued for the primary purpose of constructing a replacement hospital facility.

The Series 2007 Bonds mature on March 1, 2033 and have a variable interest rate established by the bank on a weekly basis using the weekly London Interbank Offering Rate (LIBOR) times .67, for an effective rate of 2.2 percent at June 30, 2010 (0.19 percent at June 30, 2009). Effective March 15, 2010, the LIBOR floor was set at 2.5 percent, for an effective rate floor of 1.675 percent. The bonds required monthly interest-only payments for the period from May 1, 2007 through February 27, 2009. The bonds require annual payments ranging from \$775,000 to \$2,125,000 through March 1, 2033.

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

### **Note 7 - Long-term Debt (Continued)**

The Series 2007B Bonds mature on August 1, 2032 and have a variable interest rate established by the bank on a weekly basis using the weekly LIBOR times .67, for an effective rate of 2.2 percent at June 30, 2010 (0.19 percent at June 30, 2009). The bonds required monthly interest-only payments for the period from August 1, 2007 through July 31, 2008. The bonds require annual payments ranging from \$85,000 to \$250,000 through August 1, 2032.

The bonds are secured by irrevocable direct-pay letters of credit, which expire on March 15, 2012 for the Series 2007 and Series 2007B and are secured by substantially all assets of the Hospital and affiliate, including property, equipment, accounts receivable, and inventories. The bonds are subject to mandatory redemption upon the expiration or termination of the letters of credit unless the existing letters of credit have been extended or an alternate letter of credit has been issued. The Series 2007 and Series 2007B Bonds are also guaranteed by the Hospital's sole member, Superior Healthcare System. Letters of credit fees are 1.5 percent on the Series 2007 and .85 percent on the Series 2007 B Bonds through March 2011. Effective in March 2011, these fees are 2.75 percent for the Series 2007 and Series 2007B Bonds.

The variable rate Series 2007 and Series 2007B Bonds described above are remarketed on a weekly basis. Should the remarketing agent be unable to remarket the bonds and notes based on its best efforts, the bonds and notes would be "put" back to the trustee, who would draw down on the letters of credit to pay down the Series 2007 and Series 2007B Bonds.

In connection with the above note payable to the MSHFA, the Hospital has agreed to certain financial covenants relating to debt service coverage, additional indebtedness, minimum cash requirements, minimum unrestricted net asset balance, and various other operational covenants.

In connection with the issuance of the irrevocable direct-pay letter of credit and related Series 2007 and Series 2007B Bonds, the Hospital has agreed to certain financial covenants relating to debt service coverage, days cash on hand, aging of accounts receivable, and various other operational covenants. At June 30, 2010, the Hospital was in violation of these financial covenants. Amendment No. 2 to the Reimbursement Agreement waives these financial covenants through June 30, 2011 and establishes new monthly covenants for the period from January 2011 through June 30, 2011, including modifications to certain financial covenants.

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

### **Note 7 - Long-term Debt (Continued)**

Scheduled future payments on long-term debt to maturity for the next five years and thereafter are as follows:

2011	\$ 1,014,827
2012	879,472
2013	929,472
2014	969,472
2015	1,019,472
Thereafter	<u>29,842,433</u>
Total	<u>\$ 34,655,148</u>

### **Note 8 - Interest Rate Swap Agreements**

The Hospital has entered into interest rate swaps associated with its Adjustable Rate Demand Limited Obligation Revenue Bonds, Series 2007 and 2007B. The Series 2007 Bonds' interest rate swap is in the notional amounts as detailed in the table noted below. The Series 2007B Bonds' interest rate swap is in the amount of the outstanding issuance. The Hospital has entered into these interest rate swaps to reduce the impact of changes in the interest rate on its variable rate long-term debt.

The effective date of the swap is June 1, 2007, and the swap agreement matures on March 1, 2017 for the Series 2007 Bonds. The effective date on the swap is September 1, 2007, and the swap agreement matures on August 1, 2018 for the Series 2007B Bonds. The effect of the swaps was to essentially change the Hospital's variable interest rate on bonds to a synthetic fixed rate of 3.5 percent and 3.665 percent for the Series 2007 and Series 2007B Bonds, respectively. Due to decreasing interest rates, the swaps had a negative fair value of \$2,834,776 and \$1,985,204 as of June 30, 2010 and 2009, respectively (see Note 9). The swaps' counterparty is rated "A1" by Moody's, "A" by Standard and Poor's, and "AA-" by Fitch. The Hospital or counterparty may terminate the interest rate swap agreements if either party fails to perform under the terms of a standard ISDA Master Agreement as amended. If terminated, the Hospital has the option to enter into a new interest rate swap agreement with another counterparty or to convert its variable rate bonds into fixed rate bonds. However, the Hospital does not anticipate nonperformance by the counterparties.

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

### **Note 8 - Interest Rate Swap Agreements (Continued)**

The notional amounts for each year for the Series 2007 Bonds, for which the fixed rate will apply under the interest rate swap agreement, are as follows:

	<u>Notional Amounts</u>
Effective date	\$ 20,681,250
March 1, 2010 - February 28, 2011	20,126,250
March 1, 2011 - February 28, 2012	19,545,000
March 1, 2012 - February 28, 2013	18,941,250
March 1, 2013 - February 28, 2014	18,303,750
March 1, 2014 - February 28, 2015	17,640,000
March 1, 2015 - February 28, 2016	16,942,500
March 1, 2016 - March 1, 2017	16,215,000

### **Note 9 - Other Liabilities**

The detail of other liabilities is as follows:

	<u>2010</u>	<u>2009</u>
Accrued pension cost (Note 10)	\$ 3,955,625	\$ 2,959,612
Accrued professional liability claims (Note 11)	750,000	705,921
Fair market value of interest rate swap agreement (Note 8)	2,834,776	1,985,204
Accrued obligation on old facility (Note 4)	<u>600,000</u>	<u>700,000</u>
Total other liabilities	<u>\$ 8,140,401</u>	<u>\$ 6,350,737</u>

### **Note 10 - Retirement Benefit Plans**

The Hospital has two noncontributory pension plans that together cover substantially all employees who meet service and age requirements.

Union employees are covered under a defined contribution plan that is administered under a collective bargaining arrangement. Under the defined contribution plan, the Hospital has no liability for current or prior service cost other than to pay fixed amounts per hour worked by eligible employees.

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

### **Note 10 - Retirement Benefit Plans (Continued)**

Effective November 1, 2005, nonunion employees are covered under a defined contribution plan. For those nonunion employees who were not eligible for the defined benefit plan, the plan allows employee contributions and requires a matching contribution equal to employee deferrals, up to 5.5 percent. For those nonunion employees who were eligible for the defined benefit plan, the plan allows for employee contributions and requires non-elective, monthly deferrals ranging from 7.0 percent to 10.0 percent, based on the employee's period of service as of November 1, 2005.

Pension expense under the defined contribution plans was approximately \$1,155,000 and \$1,025,000 for the years ended June 30, 2010 and 2009, respectively.

Nonunion employees are covered under a defined benefit plan that pays benefits based on, among other things, an employee's years of service and level of compensation. Effective November 1, 2005, this plan was frozen by the Hospital and participants no longer are accruing benefits under this plan. The funding policy of the Hospital is to contribute annually an amount in compliance with the requirements of the Employee Retirement Income Security Act of 1979 (ERISA). Contributions were intended to provide not only the benefits attributed to services to date, but also for those expected to be earned in the future.

#### **Obligations and Funded Status**

##### **At June 30**

	Pension Benefits	
	2010	2009
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 8,757,684	\$ 8,372,120
Interest cost	536,727	533,831
Actuarial loss	1,303,707	127,592
Benefits paid	(296,776)	(275,859)
Benefit obligation at end of year	10,301,342	8,757,684
Change in plan assets:		
Fair value of plan assets at beginning of year	5,798,339	7,391,135
Actual return on plan assets	844,154	(1,316,937)
Benefits paid	(296,776)	(275,859)
Fair value of plan assets at end of year	6,345,717	5,798,339
Funded status at end of year	\$ (3,955,625)	\$ (2,959,345)

# Bell Memorial Hospital and Affiliate

## Notes to Combined Financial Statements June 30, 2010 and 2009

### Note 10 - Retirement Benefit Plans (Continued)

Amounts recognized in the combined balance sheet consist of the following:

	Pension Benefits	
	2010	2009
Noncurrent liabilities (Note 9)	\$ (3,955,625)	\$ (2,959,612)

Amounts recognized in accumulated other comprehensive income consist of net loss of \$3,304,322 and \$2,506,053 as of June 30, 2010 and 2009, respectively.

The accumulated benefit obligation for all defined benefit pension plans was \$10,301,342 and \$8,757,684 at June 30, 2010 and 2009, respectively.

The components of net periodic benefit cost and other amounts recognized in other comprehensive income are as follows:

	Pension Benefits	
	2010	2009
<b>Net Periodic Benefit Cost</b>		
Interest cost	\$ 536,727	\$ 533,831
Expected return on plan assets	(393,980)	(506,226)
Amortization of net loss	55,264	-
Total net periodic benefit cost	\$ 198,011	\$ 27,605

### Amounts Recognized in Other Comprehensive Income

Total recognized in net periodic benefit cost and other comprehensive income	\$ 908,797	\$ 1,950,755
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The estimated net loss for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is \$55,264.

### Assumptions

Weighted average assumptions used to determine benefit obligations at June 30 are as follows:

	Pension Benefits	
	2010	2009
Discount rate	5.25 %	6.25 %

# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

### **Note 10 - Retirement Benefit Plans (Continued)**

Weighted average assumptions used to determine net periodic benefit cost for the years ended June 30 are as follows:

	Pension Benefits	
	2010	2009
Discount rate	6.25 %	6.50 %
Expected long-term return on plan assets	7.00	7.00

In selecting the expected long-term rate of return on assets, the Hospital considered the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of the plan. This included considering the allocation of trust assets and the expected returns likely to be earned over the life of the plan. The Hospital's historical rate of return on a fiscal year basis averaged approximately 7.00 percent per annum for the 10-year period ended June 30, 2010.

#### **Pension Plan Assets**

The goals of the pension plan investment program are to fully fund the obligation to pay retirement benefits in accordance with the plan documents. Pension funds will be invested in growth-oriented securities up to 65 percent equities.

The target allocation of plan assets is 69 percent equity securities, 29 percent fixed income, and 2 percent cash and cash equivalents.

Equity securities primarily include investments in large-cap and mid-cap companies primarily located in the United States. Fixed-income securities include corporate bonds of companies from diversified industries, mortgage-backed securities, and U.S. Treasuries.

# Bell Memorial Hospital and Affiliate

## Notes to Combined Financial Statements June 30, 2010 and 2009

### Note 10 - Retirement Benefit Plans (Continued)

The fair values of the Hospital's pension plan assets at June 30, 2010 by major asset classes are as follows:

#### Fair Value Measurements at June 30, 2010

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Asset Classes</b>				
Equity (a)	\$ 2,151,766	\$ 2,151,766	\$ -	\$ -
International (b)	651,980	651,980	-	-
Small-cap (c)	945,880	945,880	-	-
Large-cap (d)	184,169	184,169	-	-
Wells Fargo proprietary funds (e)	2,411,922	2,411,922	-	-
Total	\$ 6,345,717	\$ 6,345,717	\$ -	\$ -

- (a) Mutual funds which invest primarily in stocks, usually common stocks
- (b) Mutual funds which invest in securities throughout the world
- (c) Mutual funds which invest in small capital funds, from \$250 million to \$1 billion
- (d) Mutual funds which invest primarily in stocks of large companies with above-average prospects for growth
- (b) Fixed-income funds which focus on the determination of operating income, changes in equity (or cost recovery), financial position, and cash flows

The above table presents information about the pension benefit plan assets measured at fair value at June 30, 2010, and the valuation techniques used by the Hospital to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Hospital has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset.



# **Bell Memorial Hospital and Affiliate**

## **Notes to Combined Financial Statements June 30, 2010 and 2009**

### **Note 10 - Retirement Benefit Plans (Continued)**

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Hospital's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each plan asset.

#### **Cash Flow**

##### **Contributions**

The Hospital has no minimum required contributions to make to the pension plan during 2011, however, the Hospital has not determined if any contributions will be made to the pension plan during 2011.

##### **Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

<u>Year Ending December 31</u>	<u>Pension Benefits</u>
2011	\$ 314,649
2012	331,925
2013	365,038
2014	420,639
2015	449,922
2016-2020	3,182,846

### **Note 11 - Professional Liability Insurance**

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 bears the risk of the ultimate costs of any individual and aggregate claims exceeding the policy limits for claims asserted in the policy year. The Hospital has accrued the estimated outstanding claims as of June 30, 2010 and 2009 (see Note 9).

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.

## **Bell Memorial Hospital and Affiliate**

### **Notes to Combined Financial Statements June 30, 2010 and 2009**

#### **Note 12 - Functional Expenses**

The Hospital is a general acute-care facility that provides inpatient and outpatient health-care services to patients in Ishpeming, Michigan and surrounding communities. Expenses related to providing these services for the years ended June 30, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Healthcare services	\$ 45,272,338	\$ 43,093,104
General and administrative	<u>11,196,046</u>	<u>10,187,256</u>
Total	<u>\$ 56,468,384</u>	<u>\$ 53,280,360</u>

## **Additional Information**

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Plante & Moran, PLLC  
Suite 100  
1111 Michigan Ave.  
East Lansing, MI 48823  
Tel: 517.332.6200  
Fax: 517.332.8502  
plantemoran.com

## Independent Auditor's Report on Additional Information

To the Board of Directors  
Bell Memorial Hospital and Affiliate

We have audited the combined financial statements of Bell Memorial Hospital and Affiliate as of June 30, 2010 and 2009. 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 operations information is presented for the purpose of additional analysis of the combined financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities and is not a required part 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*

March 28, 2011

# Bell Memorial Hospital and Affiliate

## Combining Balance Sheet June 30, 2010

	Bell Memorial Hospital	Bell Medical Center	Eliminating Entries	Total
<b>Assets</b>				
<b>Current Assets</b>				
Cash and cash equivalents	\$ 6,433,839	\$ -	\$ -	\$ 6,433,839
Accounts receivable	4,983,105	1,657,274	-	6,640,379
Estimated third-party payor settlements	622,791	-	-	622,791
Inventory	1,618,717	32,817	-	1,651,534
Prepaid expenses and other	287,811	36,464	-	324,275
Total current assets	13,946,263	1,726,555	-	15,672,818
<b>Property and Equipment - Net</b>	45,151,542	635,489	-	45,787,031
<b>Other Assets</b>	4,353,278	6,207	-	4,359,485
Total assets	<u>\$ 63,451,083</u>	<u>\$ 2,368,251</u>	<u>\$ -</u>	<u>\$ 65,819,334</u>
<b>Liabilities and Net Assets</b>				
<b>Current Liabilities</b>				
Current portion of long-term debt	\$ 1,014,827	\$ -	\$ -	\$ 1,014,827
Accounts payable	1,810,585	135,667	-	1,946,252
Estimated third-party payor settlements	1,648,228	-	-	1,648,228
Accrued liabilities	2,130,144	525,365	-	2,655,509
Total current liabilities	6,603,784	661,032	-	7,264,816
<b>Long-term Debt - Net of current portion</b>	33,357,707	-	-	33,357,707
<b>Other Liabilities</b>	8,140,401	-	-	8,140,401
Total liabilities	48,101,892	661,032	-	48,762,924
<b>Net Assets</b>				
Unrestricted	13,523,655	1,707,219	-	15,230,874
Temporarily restricted	1,825,536	-	-	1,825,536
Total liabilities and net assets	<u>\$ 63,451,083</u>	<u>\$ 2,368,251</u>	<u>\$ -</u>	<u>\$ 65,819,334</u>

# Bell Memorial Hospital and Affiliate

## Combining Statement of Operations Year Ended June 30, 2010

	Bell Memorial Hospital	Bell Medical Center	Eliminating Entries	Total
<b>Unrestricted Revenue, Gains, and Other Support</b>				
Total patient service revenue	\$ 73,754,103	\$ 13,234,851	\$ -	\$ 86,988,954
Revenue deductions	(34,646,954)	(4,994,687)	-	(39,641,641)
Net patient service revenue	39,107,149	8,240,164	-	47,347,313
Other	961,406	1,128,044	-	2,089,450
Total unrestricted revenue, gains, and other support	40,068,555	9,368,208	-	49,436,763
<b>Expenses</b>				
Salaries and wages	15,792,332	7,958,544	-	23,750,876
Employee benefits	4,780,359	1,551,007	-	6,331,366
Supplies	5,423,108	686,849	-	6,109,957
Purchased services	1,395,467	1,324,743	-	2,720,210
Insurance	378,900	189,237	-	568,137
Other healthcare expenses	5,045,062	571,048	-	5,616,110
Depreciation and amortization	2,514,569	355,706	-	2,870,275
Provision for bad debts	4,890,046	1,615,239	-	6,505,285
Interest expense	1,880,984	115,184	-	1,996,168
Total expenses	42,100,827	14,367,557	-	56,468,384
<b>Operating Loss</b>	(2,032,272)	(4,999,349)	-	(7,031,621)
<b>Other Income (Expense)</b>				
Investment income	402,991	-	-	402,991
Contributions	634,142	-	-	634,142
Net change in unrealized gains and losses on investments	286,954	-	-	286,954
Change in fair value of interest rate swap agreements (Note 8)	(849,572)	-	-	(849,572)
Total other income	474,515	-	-	474,515
<b>Excess of Revenue Under Expenses</b>	(1,557,757)	(4,999,349)	-	(6,557,106)
<b>Transfer (to) from Affiliate</b>	(4,586,198)	4,586,198	-	-
<b>Pension-related Changes Other Than Net Periodic Pension Costs</b>	(908,797)	-	-	(908,797)
<b>Decrease in Unrestricted Net Assets</b>	<u>\$ (7,052,752)</u>	<u>\$ (413,151)</u>	<u>\$ -</u>	<u>\$ (7,465,903)</u>