Consolidated Financial Statements

The Detroit Medical Center and Subsidiaries
Years Ended December 31, 2007 and 2006
With Report of Independent Auditors

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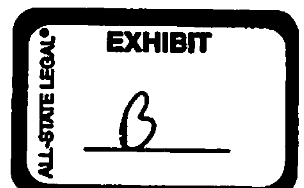

The Detroit Medical Center and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2007 and 2006

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Report of Independent Auditors

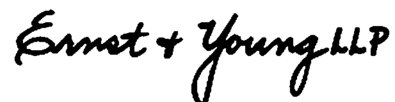
The Board of Trustees
The Detroit Medical Center

We have audited the accompanying consolidated balance sheets of The Detroit Medical Center and subsidiaries (The DMC) as of December 31, 2007 and 2006, and the related consolidated statements of operations and changes in net assets (deficit), and cash flows for the years then ended. These financial statements are the responsibility of The DMC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of The DMC's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of The DMC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Detroit Medical Center and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and changes in net assets (deficit), and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Notes 9 and 10 to the consolidated financial statements, The Detroit Medical Center adopted the recognition provisions of Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, in 2007, which changed its method of accounting for its defined benefit pension and postretirement benefit plans.



May 20, 2008

The Detroit Medical Center and Subsidiaries

Consolidated Balance Sheets

	December 31 2007	December 31 2006
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 9,173	$ 23,791
Net patient accounts receivable *(Note 3)*	93,517	98,806
Estimated third-party payor settlements *(Note 3)*	10,784	19,906
Other accounts receivable	28,889	28,349
Current portion of assets whose use is limited or restricted	6,009	8,009
Securities lending collateral	54,311	66,620
Supplies	20,109	21,610
Prepaid expenses and other	31,980	30,336
Total current assets	254,772	297,427
Assets whose use is limited or restricted, less current portion (including securities pledged to creditors of $53,058 and $64,753, respectively) *(Note 4)*:		
Board-designated funds for capital improvements	36,506	34,604
Board-designated funds for specific purposes	71,392	75,339
Professional liability funds	204,397	197,214
Funds held in trust under bond agreements *(Note 7)*	34,377	34,949
Endowment funds	60,264	59,183
Pledges receivable	13,955	16,338
Donor restricted funds	94,269	89,742
	515,160	507,369
Property and equipment, net *(Note 2)*	467,736	484,119
Prepaid retirement asset *(Note 9)*	57,583	–
Other noncurrent assets *(Note 2)*	30,427	30,076
Total assets	$ 1,325,678	$ 1,318,991

	December 31	
	2007	2006
	(In Thousands)	
Liabilities and net assets (deficit)		
Current liabilities:		
Revolving line of credit notes *(Note 6)*	$ 19,252	$ –
Accounts payable and accrued expenses	171,239	179,254
Accrued compensation and related amounts	54,283	51,726
Estimated third-party payor settlements *(Note 3)*	7,948	20,627
Advance payment from third-party payor	24,876	47,730
Payable under securities lending program	54,311	66,620
Current portion of long-term debt *(Note 7)*	25,029	23,018
Current portion of accrued retirement liability *(Note 9)*	–	33,831
Current portion of accrued professional liability losses *(Note 8)*	18,052	24,897
Total current liabilities	374,990	447,703
Other liabilities:		
Long-term debt, less current portion *(Note 7)*	533,544	553,076
Noncurrent accrued retirement liability *(Note 9)*	–	31,747
Other noncurrent liabilities, less current portion *(Notes 2, 8, and 10)*	250,937	228,922
Total other liabilities	784,481	813,745
Total liabilities	1,159,471	1,261,448
Net assets (deficit):		
Unrestricted:		
Operations	(2,283)	(40,186)
Additional minimum pension liability	–	(67,532)
	(2,283)	(107,718)
Temporarily restricted	103,644	100,511
Permanently restricted	64,846	64,750
Total net assets	166,207	57,543
Total liabilities and net assets	$ 1,325,678	$ 1,318,991

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (Deficit)

	Year Ended December 31	
	2007	2006
	(In Thousands)	
Unrestricted revenue and other support		
Net patient service revenue *(Note 3)*	$ 1,788,156	$ 1,688,752
Revenue from services and facility agreements *(Note 14)*	61,238	76,849
Other revenue	64,635	66,458
Net assets released from restrictions for operations	10,164	11,492
Total unrestricted revenue and other support	1,924,193	1,843,551
Expenses		
Salaries, wages, and benefits	737,892	716,406
Services, supplies, and other *(Note 13)*	740,915	724,033
Provision for uncollectible accounts	265,594	243,293
Professional liability insurance *(Note 8)*	25,108	21,149
Interest	36,632	34,763
Depreciation and amortization	80,844	77,088
Total expenses	1,886,985	1,816,732
Income from operations before impairment charge and change in unrealized gains (losses) on investments	37,208	26,819
Change in unrealized gains (losses) on investments	(4,837)	5,653
Impairment charge *(Note 15)*	–	(3,998)
Income from operations	32,371	28,474
Other nonoperating income:		
Gain on sale of interest in joint venture	–	3,087
Investment income and other	1,396	9,314
Excess of revenue over expenses	33,767	40,875

Continued on next page.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Operations
and Changes in Net Assets (Deficit) (continued)

	Year Ended December 31	
	2007	2006
	(In Thousands)	
Unrestricted net assets		
Excess of revenue over expenses	$ 33,767	$ 40,875
Net assets released from restrictions for long-lived assets	8,176	5,302
Change in additional minimum pension liability	67,532	61,041
Effect of adopting recognition provisions of FAS 158	(3,498)	–
Other changes	(542)	(487)
Increase in unrestricted net assets	105,435	106,731
Temporarily restricted net assets		
Contributions	12,194	14,811
Investment income	11,304	15,170
Change in unrealized gain in fair value of investments	(2,162)	2,359
Net assets released from restrictions for long-lived assets	(8,176)	(5,302)
Net assets released from restrictions for operations	(10,164)	(11,492)
Other changes	137	(838)
Increase in temporarily restricted net assets	3,133	14,708
Permanently restricted net assets		
Contributions	96	111
Other changes	–	(669)
Increase (decrease) in permanently restricted net assets	96	(558)
Increase in net assets	108,664	120,881
Net assets (deficit) at beginning of year	57,543	(63,338)
Net assets at end of year	$ 166,207	$ 57,543

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2007	2006
	(In Thousands)	
Operating activities		
Increase in net assets	$ 108,664	$ 120,881
Adjustments to reconcile increase in net assets to cash provided by operating activities:		
Depreciation and amortization	80,844	77,088
Provision for uncollectible accounts	265,594	243,293
Gain on sale of joint venture interest	–	(3,089)
Additional minimum pension liability *(Note 9)*	(67,532)	(61,041)
Effect of adopting recognition provisions of FAS 158	3,498	–
Impairment charge	–	3,998
Changes in operating assets and liabilities:		
Investments	(5,791)	(50,626)
Patient accounts receivable	(260,305)	(256,851)
Estimated third-party payor settlements	9,122	(600)
Other current assets	(683)	4,168
Accounts payable and accrued expenses	(7,803)	(4,598)
Other current liabilities	2,557	429
Due to third-party payors	(12,679)	895
Advance from third-party payor	(22,854)	22,072
Accrued retirement liability	(57,611)	(65,488)
Accrued professional liability losses	13,088	262
Other operating activities	(660)	(3,260)
Cash provided by operating activities	47,449	27,533
Investing activities		
Purchase of property and equipment	(64,084)	(49,840)
Proceeds from sale of joint venture interest	–	3,089
Other investing activities	6,444	315
Cash used in investing activities	(57,640)	(46,436)
Financing activities		
Borrowings on line of credit	453,759	290,340
Repayments on line of credit	(434,507)	(290,340)
Repayment of long-term debt	(23,679)	(22,077)
Cash used in financing activities	(4,427)	(22,077)
Decrease in cash and cash equivalents	(14,618)	(40,980)
Cash and cash equivalents at beginning of year	23,791	64,771
Cash and cash equivalents at end of year	$ 9,173	$ 23,791

See accompanying notes.

1. Organization and Significant Accounting Policies

Organization

The Detroit Medical Center, a parent holding company, and its subsidiaries (jointly The DMC) are major providers of health care services to residents of the Detroit metropolitan area. The DMC constitutes the academic health center of Wayne State University, and works with the University to integrate clinical services, education, and research.

The consolidated financial statements of The DMC include The Detroit Medical Center and the corporations listed below, as well as their subsidiaries:

Associated Hospitals Processing Facility
Berry Center, LLC
Children's Hospital of Michigan [A]
Children's Choice of Michigan
DMC Insurance Co., Ltd. (see Note 8)
DMC Nursing Homes, Inc.
DMC Partnership Imaging
DMC Physician Group
Detroit Receiving Hospital and University Health Center (Detroit Receiving) [A]
Harper-Hutzel Hospital [A]
HealthSource
Huron Valley–Sinai Hospital, Inc. [A]
Radius Health Care System, Inc.
Rehabilitation Institute of Michigan [A]
Sinai-Grace Hospital [A]

[A] Members of The Detroit Medical Center Obligated Group (see Note 7).

These corporations consist of both membership and stock corporations, the sole member or majority stockholder of which is The Detroit Medical Center. Such corporations are referred to herein as the subsidiaries of The DMC. The consolidated financial statements include the accounts of The Detroit Medical Center and all majority-owned subsidiaries.

The DMC has an investment in and accounts for CareTech Corporation using the equity method of accounting. All significant intercompany account balances and transactions have been eliminated in consolidation.

1. Organization and Significant Accounting Policies (continued)

Mission

The DMC is committed to improving the health of the population served by providing the highest quality health care services in a caring and efficient manner without invidious discrimination, regardless of the person's religion, race, gender, ethnic identification, or economic status. Together with Wayne State University, The DMC strives to be the region's premier health care resource through a broad range of clinical services; the discovery and application of new knowledge; and the education of practitioners, teachers, and scientists.

As part of its public mission as the safety net health care provider in Southeast Michigan, The DMC writes off forgone charges associated with providing services to uninsured patients. This public mission support is determined by isolating the amount of bad debts originating from care to uninsured patients less any monies received by The DMC from third parties (Medicare, Medicaid, and Blue Cross) as a qualified disproportionate share hospital (DSH). The DMC also considers payments remitted to Wayne State University faculty physicians as recognition of care provided by such physicians to the uninsured population.

Cash and Cash Equivalents

The DMC considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Investments

Investments in equity securities and debt securities are measured at fair value in the consolidated balance sheets. Fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar securities. Donated items are stated at fair value at the date of contribution. Investment income (including realized and unrealized gains and losses on investments, interest and dividends) are included in the excess of revenue and expenses unless the income is restricted by donor or law.

In 2006 and prior years, the investment portfolio was classified as nontrading and, as such, unrealized gains and losses considered temporary were excluded from the excess of revenue over expenses. In 2006 and prior years, unrealized gains and losses which were considered temporary were included in other changes in unrestricted net assets. During 2007 The DMC determined that substantially all of its investment portfolio was more accurately classified as trading, with unrealized gains and losses included in the excess of revenue over expenses. Therefore, the

1. Organization and Significant Accounting Policies (continued)

accompanying 2006 financial statements include a reclassification of $6,603,000 related to this change. The reclassification did not change the increase in net assets previously reported, the consolidated balance sheet or the increase in cash and cash equivalents reported on the consolidated statement of cash flows.

Investments in limited partnerships, such as private equity investments and hedge funds, are reported using the equity method of accounting based on information provided by the respective partnership. The investment information provided by the respective partnerships are based on current market value, appraisals, or other estimates that require varying degree of judgments. If no public market exists for the alternative investment, the fair value is determined by the general partner taking into consideration, among other things, the cost of the securities, prices of significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate. There is inherent uncertainty in such valuations and the estimated fair values may differ from the values that would have been used had a ready market for the securities existed. Generally, The DMC's holdings in alternative investments reflects net contributions to the partnership and an ownership share of realized and unrealized investment income and expenses. The components of some of the individual investments within these funds are not readily marketable, their estimated value is subject to uncertainty and may differ from the value that would have been had a ready market for the investments existed. Such a difference could be material. Alternative investments have liquidity restrictions. Amounts can be divested only at specified times based on the terms of the partnership agreement.

Securities Lending Program

The DMC participates in securities lending transactions with Northern Trust, investment custodian, whereby a portion of its investments are loaned to selected established brokerage firms in return for cash and securities from the brokers as collateral for the investments loaned, usually on a short-term basis of 30 to 60 days. Collateral provided by brokers is maintained at levels approximating 102% of the fair value of the securities on loan and is adjusted for daily market fluctuations. The market value of collateral held for loaned securities is reported as securities lending collateral in the consolidated balance sheet. At December 31, 2007 and 2006, investment securities with an aggregate market value of $53,058,000 and $64,753,000, respectively; were loaned to various brokers and are returnable upon demand. In exchange, The DMC received cash collateral of $54,311,000 and $66,620,000, respectively. The 2006 financial statements have been restated to reflect participation in the securities lending program which was not previously reported.

1. Organization and Significant Accounting Policies (continued)

Patient Service Revenue and Receivables

The majority of The DMC's services are reimbursed under fixed price provisions of third-party payment programs (primarily Medicare, Medicaid, and Blue Cross and Blue Shield of Michigan). Under these provisions, payment rates for patient care are determined prospectively on various bases and The DMC's revenues are limited to such amounts. Payments are also received from third parties for The DMC's capital and medical education costs, subject to certain limits. Additionally, The DMC has entered into agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined per diem rates, capitation agreements, and discounts from established charges.

Net patient service revenue is reported at the estimated net realizable amounts to be received 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 related services are rendered and 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. Management believes that adequate provision has been made in the consolidated financial statements for any adjustments that may result from final settlements.

The DMC receives payments from the state Medicaid program related to support of the DMC's indigent patient volume. The payments are recognized ratably as revenue over the period of support determined by the State.

Revenue from the Medicare and Medicaid programs accounted for approximately 24% and 25% in 2007, respectively, and 24% and 22% in 2006, respectively, of net patient service revenues. 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. Compliance with such laws and regulations is subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

In the normal course of business, The DMC has received requests for information from governmental agencies covering services provided. Management intends to fully cooperate with the governmental agencies in its request for information and believes that adequate provision has been made for any adjustments that may result from settlements.

1. Organization and Significant Accounting Policies (continued)

The provision for bad debts is based upon management's assessment of expected net collections and considers business and economic conditions, trends in health care coverage and other collection indicators including historical write-off experience by payor category. The results of this review are then used to make any modifications to the provision for bad debts to establish an appropriate allowance for uncollectible receivables. After receipt of amounts due from insurance, The DMC follows established guidelines for placing certain past due patient balances with collection agencies.

Supplies

Supplies represent medical supplies which are stated at the lower of cost or market. Cost is determined based on the first-in, first-out method.

Property and Equipment

Property and equipment, including amounts under capital leases, are stated at cost or estimated fair value at the date of donation, and are depreciated by the straight-line method over their estimated useful lives. The estimated useful lives for assets ranges from 3 years to 40 years.

FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47), clarifies the term "conditional asset retirement obligation" as used in FASB Statement 143, *Accounting for Asset Retirement Obligations* (FASB 143). FIN 47 states that the obligation to perform an asset retirement activity is unconditional if there is a legal obligation to perform the retirement. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be estimated. Because there are no current plans requiring remediation giving rise to an asset retirement obligation and a settlement date has not been specified by others, management believes that sufficient information is not available to record an asset retirement obligation.

Other Noncurrent Assets

Other noncurrent assets include deferred debt issuance costs which are amortized ratably over the terms of the related debt issues using a method that approximates the interest method. Other intangible assets are amortized by the straight-line method over a ten-year period (see Note 2).

1. Organization and Significant Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific purpose, such as capital additions or research. When a donor restriction is satisfied, such as through expenditure for the restricted purpose, temporarily restricted net assets are reclassified as net assets released from restrictions for either operating purposes or for long-lived assets and are included in unrestricted revenues and other support, or as an other increase in unrestricted net assets, respectively. Pledges are recorded as increases in temporarily restricted net assets when the pledge is made.

Permanently restricted net assets have been restricted by the donors to be maintained by The DMC in perpetuity, the income therefrom to be used in accordance with any restrictions by the donor.

Excess of Revenue Over Expenses

The statement of operations and changes in net assets (deficit) includes the excess of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess of revenue over expenses, consistent with industry practice, include changes in the additional minimum pension liability and net assets released from restrictions for the purchase of long-lived assets.

Charity Care

The DMC provides health care services free of charge or at reduced rates to individuals who meet certain eligibility criteria, based on published Income Poverty Guidelines. Charity care may also be provided to other patients at the discretion of the management of the hospital providing the care. Charity care provided by The DMC is included in the provision for uncollectible accounts on the statement of operations.

Impairment of Long-Lived Assets

In accordance with the Financial Accounting Standards Board (FASB) Statement No. 144, *Accounting for the Impairment of Long-Lived Assets*, The DMC performs an evaluation of impairment losses on long-lived assets used in operations when events and circumstances indicate that long-lived assets might be impaired. If the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets, an impairment charge is recorded and the amount of the impairment is determined based on the fair market value of the asset.

1. Organization and Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

Income Taxes

The Detroit Medical Center, each of its hospital subsidiaries and certain of its other subsidiaries are nonprofit corporations, exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. Radius Health Care System, Inc. is a for-profit corporation, which has net operating loss carryforwards that are available to offset its future taxable income. The DMC uses the liability method of accounting for income taxes under which deferred taxes are determined based on the differences between financial statement and tax bases of assets and liabilities, using current tax rates. The DMC has recorded a valuation allowance equal to the deferred tax asset associated with the net operating loss carryforwards, as such amounts are not considered recoverable.

Adoption of New Accounting Standards

In September 2006, the FASB issued FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, and amendment of FASB Statements No 87, 88, 106, and 132(R)* (Statement 158). Statement 158 requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, postretirement benefit plans) to recognize the funded status of their postretirement benefit plans in the statement of financial position, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end statement of financial position, and provide additional disclosures. On December 31, 2007, The DMC adopted the recognition and disclosure provisions of Statement 158. The adoption of Statement 158 resulted in a net charge of $3,498,000 to unrestricted net assets within the accompanying consolidated statement of operations and changes in net assets (deficit). Of the $3,498,000 net charge, $1,982,000 relates to the defined benefit plan and $1,516,000 relates to other postretirement benefit plans. Statement 158 did not have an effect on The DMC's consolidated financial position at December 31, 2006. See Notes 9 and 10 for further discussion of the effect of adopting FASB Statement No. 158 on The DMC's consolidated financial statements.

1. Organization and Significant Accounting Policies (continued)

In 2007, The DMC adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). The effect of adopting FIN 48 was not significant.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosure about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The DMC has not determined the effect that adoption of SFAS 157 will have on its financial statements.

Reclassifications

Certain 2006 amounts have been reclassified to conform with the 2007 presentation.

2. Additional Balance Sheet Information

	December 31	
	2007	2006
	(In Thousands)	
Property and equipment:		
Land and land improvements	$ 10,090	$ 9,646
Buildings and improvements	809,535	800,694
Equipment	1,105,965	1,067,422
Construction in progress	16,173	11,885
	1,941,763	1,889,647
Accumulated depreciation	(1,474,027)	(1,405,528)
	$ 467,736	$ 484,119

2. Additional Balance Sheet Information (continued)

	December 31 2007	December 31 2006
	(In Thousands)	
Other noncurrent assets:		
Goodwill and other intangible assets	$ 10,699	$ 11,441
Accumulated amortization	(9,813)	(9,318)
	886	2,123
Deferred debt issuance costs, net of accumulated amortization	10,365	11,204
Investment held for deferred compensation	1,685	1,681
Investment in unconsolidated affiliates	7,881	7,675
Other	9,610	7,393
	$ 30,427	$ 30,076
Other noncurrent liabilities, less current portion:		
Accrued professional liability losses	$ 202,384	$ 182,451
Other postretirement liability	15,701	14,767
Deferred compensation liability	2,235	1,681
Minority interest in Berry Center, LLC	1,118	640
Other	29,499	29,383
	$ 250,937	$ 228,922

3. Net Patient Service Revenue and Accounts Receivable

Net patient service revenue consists of the following:

	Year Ended December 31 2007	2006
	(In Thousands)	
Gross revenue from services to patients	$ 3,781,638	$ 3,625,588
Contractual adjustments	(2,005,604)	(1,959,161)
Changes in estimate related to favorable prior year third-party payor settlements	12,122	22,325
Net patient service revenue	$ 1,788,156	$ 1,688,752

Net patient accounts receivable consists of the following:

	December 31 2007	2006
	(In Thousands)	
Gross patient accounts receivable	$ 551,510	$ 488,387
Allowances and advances under contractual arrangements	(389,741)	(334,113)
Allowance for uncollectible accounts	(68,252)	(55,468)
	$ 93,517	$ 98,806

The DMC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Significant concentrations of accounts receivable at December 31, 2007 and 2006, include net amounts due from Medicare (19% and 19%), Medicaid (14% and 12%), Blue Cross (14% and 14%), and other payors, (53% and 55%), respectively.

4. Assets Whose Use is Limited

Investments and cash and cash equivalents are summarized as follows:

	December 31	
	2007	2006
	(In Thousands)	
Cash and cash equivalents	$ 95,194	$ 112,028
United States government obligations	29,526	37,046
Foreign obligations	11,547	7,499
Asset and mortgage-backed securities	77,643	65,395
Corporate bonds	72,204	64,842
Common stock	191,143	202,975
Limited partnerships	38,801	31,937
Other	329	1,109
	$ 516,387	$ 522,831

Investment return is summarized as follows:

	Year Ended December 31	
	2007	2006
	(In Thousands)	
Interest and dividends	$ 31,393	$ 4,197
Net realized gains	1,771	29,342
Net unrealized gains (losses)	(7,391)	8,700
Total investment income	$ 25,773	$ 42,239
Included in other revenue	$ 18,532	$ 8,381
Included in change in unrealized gain (losses) on investments	(4,837)	5,653
Included in other nonoperating income	2,936	10,676
	16,631	24,710
Included in temporarily restricted net assets	9,142	17,529
Total investment income	$ 25,773	$ 42,239

4. Assets Whose Use is Limited (continued)

Investment return on board-designated funds for capital improvements is included in other nonoperating income. All other investment return, which is not restricted by explicit donor stipulations, is included in other revenue, except for unrealized gains/losses which are included as a component of the performance indicator. Equity earnings on limited partnerships is included in the realized gain (loss) amount.

5. Fair Value of Financial Instruments

The following methods and assumptions were used in estimating fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts in the balance sheets for cash and cash equivalents approximate fair value.

Assets whose use is limited: The fair values for marketable debt and equity securities are based on quoted market prices.

Long-term debt: The fair values for long-term debt are estimated using discounted cash flow analyses based on current borrowing rates for similar types of borrowing arrangements.

The carrying amounts and fair values of cash and cash equivalents and assets whose use is limited or restricted are as follows:

	December 31	
	2007	**2006**
	(In Thousands)	
Cash and cash equivalents	$ 9,173	$ 23,791
Current portion of assets whose use is limited	6,009	8,009
Assets whose use is limited or restricted, less current portion	501,205	491,031

5. Fair Value of Financial Instruments (continued)

The carrying amount and fair value of long-term debt, excluding capital lease obligations, is as follows:

	December 31	
	2007	2006
	(In Thousands)	
Carrying amount	$ 520,217	$ 534,480
Fair value	545,530	549,260

6. Credit Agreement

On May 7, 2007, the DMC and GE Capital executed an amended and restated credit agreement. Under the amended terms of the credit agreement, the DMC has liquidity available of up to $60,000,000 based on eligible accounts receivable which is determined based on net accounts receivable which are less than 120 days old reduced by third-party advances and allowances for doubtful accounts. The DMC has the ability to increase the available liquidity up to $80,000,000 based on eligible accounts receivable. The credit agreement, which expires June 30, 2010, is secured by eligible accounts receivable. Under the terms of the credit agreement, the DMC is required to have days in accounts receivable less than 97 days, maintain liquidity of $50,000,000 on a monthly basis and average liquidity of $65,000,000 for the preceding three month period, and maintain a fixed charge coverage ratio. Interest on borrowings can either be fixed or floating subject to monthly adjustments (the interest rate at December 31, 2007 ranged from 6.715% to 7.25%). In addition, the DMC is charged an unused facility fee equal to .25% of the unused liquidity facility. At December 31, 2007, the balance outstanding on the line of credit was $19,072,000.

In addition, The DMC has $180,000 outstanding on other lines of credit that are utilized by consolidated joint ventures.

7. Long-Term Debt and Leases

Long-term debt consists of the following:

	December 31	
	2007	**2006**
	(In Thousands)	
Michigan State Hospital Finance Authority (MSHFA) bonds:		
Series 1988A and 1988B, interest at 8.125%, due 2010	**$ 2,575**	$ 2,575
Series 1993A, interest at 6.25% to 6.5%, due 2018	**108,705**	108,820
Series 1993B, interest at 5.20% to 5.75%, due 2023	**104,245**	110,785
Series 1995, interest at 6.0% to 6.7%, due 2026	**33,945**	35,635
Series 1997A, interest at 5.0% to 5.5%, due 2027	**155,396**	159,236
Series 1998A, interest at 5.0% to 5.25%, due 2028	**108,650**	108,650
Obligations under capital leases	**38,356**	41,614
Notes payable and other obligations	**6,701**	8,779
	558,573	576,094
Less current portion	**25,029**	23,018
	$ 533,544	$ 553,076

The Detroit Medical Center and its hospital subsidiaries are members of The Detroit Medical Center Obligated Group, which was created under a Master Indenture and Security Agreement. In addition, The Detroit Medical Center and its hospital subsidiaries became part of Sinai Hospital Obligated Group, which was created under a separate Master Indenture, which also became known as The Detroit Medical Center Obligated Group subsequent to the 1997 acquisition of Sinai Hospital by The DMC. Collectively these Master Indentures are referred to as "Master Indentures." The Master Indentures provide that each member of the Obligated Group is jointly and severally liable for obligations issued thereunder. The Detroit Medical Center serves as Obligated Group Agent.

The MSHFA bonds are tax-exempt revenue bonds secured by obligations issued under the Master Indenture, which the Obligated Group must repay under loan agreements with MSHFA. The bonds mature in annual amounts through 2028, ranging in the aggregate from $12,770,000 in 2008 to $37,585,000 in 2028.

7. Long-Term Debt and Leases (continued)

On June 29 and June 30, 2004, The DMC entered into Forbearance Agreements with the trustees under the Master Indentures as a result of not achieving the required debt service coverage ratio for the year ended December 31, 2003. Under the terms of the Forbearance Agreements, the trustees agreed to forbear their right to exercise any rights or remedies related to the failure to meet the debt service coverage ratio. The Forbearance Agreements require The DMC to maintain a debt service coverage ratio computed on an annualized basis of 1.2, maintain liquidity of $65,000,000 and 15 days cash on hand, and provide quarterly compliance certificates. The DMC was required to comply with such covenants until The DMC complies with the covenants for any consecutive three-year period, and no event of default occurs during such period, however, these covenants do not extend beyond June 30, 2009. As of June 30, 2007, the DMC had complied with the covenants for a consecutive three-year period, and thus no additional compliance with the forbearance agreement was required.

Portions of the proceeds of the Series 1988A, 1988B, 1993A, 1993B, and 1995 Bonds, as well as the Series 1997A Bonds, were deposited into escrow funds to advance refund previously issued hospital revenue bonds. The principal outstanding under all of these previous issues, amounting to $6,385,000 at December 31, 2007, is considered to be extinguished for financial reporting purposes and will be paid from the escrow funds.

Interest paid was $33,506,000 in 2007 and $33,720,000 in 2006. In addition, The DMC capitalized interest of $81,000 and $281,000 in 2007 and 2006, respectively.

The cost and accumulated depreciation for assets under capital lease were $59,837,000 and $24,972,000 at December 31, 2007, and $49,063,000 and $17,419,000 at December 31, 2006.

7. Long-Term Debt and Leases (continued)

Future maturities of long-term debt and future minimum payments under capital leases are summarized as follows:

	Bonds and Notes Payable	Capital Leases
	(In Thousands)	
2008	$ 14,390	$ 13,307
2009	13,786	12,467
2010	14,653	8,647
2011	17,930	4,260
2012	17,974	1,907
Thereafter	441,484	5,516
	$ 520,217	46,104
Less amounts representing interest		7,748
		$ 38,356

Rent expense incurred under operating noncancellable leases was $17,111,000 in 2007 and $17,137,000 in 2006. The DMC has noncancellable lease commitments at December 31, 2007, as follows (in thousands):

2008	$ 11,409
2009	9,046
2010	8,578
2011	8,170
2012	6,439

8. Professional and General Liability Claims

The Detroit Medical Center has established an offshore captive insurance company to provide professional and general liability coverage to The Detroit Medical Center, its hospital subsidiaries, certain medical staff members, and other affiliates. A portion of the risk of loss from professional liability claims is retained by some of the subsidiaries. Through March 31, 2004, The DMC acquired excess professional liability and general liability coverage from a captive insurance company in which it holds a minority interest. Effective April 1, 2004, The DMC purchased the excess coverage from the offshore captive owned by The DMC, which in turn reinsured the losses through commercial insurance companies.

The DMC and its affiliates have accrued their best estimate of the ultimate cost of losses payable by the captive insurance company and the retained portion of losses under other insurance arrangements. These estimates include an amount for claims incurred but not reported.

Accrued professional liability losses are recorded at their estimated present value based on discount rates, which average approximately 6.0% in 2007 and 2006. Professional liability expense was $25,108,000 in 2007 and $21,149,000 in 2006.

9. Retirement Benefits

Effective April 2004, The DMC maintains a defined contribution retirement plan for employees. The DMC contributes a fixed percentage of employee salaries to the plan and also matches contributions made by employees to the defined contribution plan during the year. Total expense under the plan was $12,902,000 in 2007 and $11,537,000 in 2006.

The DMC also has a noncontributory defined benefit retirement plan covering substantially all of the employees of The Detroit Medical Center and its subsidiaries hired prior to June 1, 2003. The benefits under the defined benefit plan are based in general on years of service and final average earnings.

In 2003, The DMC announced that benefits provided under the defined benefit retirement plan would be frozen effective June 1, 2003. Management elected to freeze the pension benefits to reduce the expected increase in pension expense subsequent to 2003. A curtailment gain was recognized in 2003 as a result of freezing the pension benefits. In 2007, The DMC recognized a curtailment gain and reduction in the accumulated benefit obligation of $2,159,000 related to a change in the amount of benefits for a collective bargaining unit.

9. Retirement Benefits (continued)

The DMC's funding policy for the defined benefit plan is, in general, to fund an amount based on the recommendation of consulting actuaries that is in compliance with the requirements of the Employee Retirement Income Security Act of 1974. On October 4, 2004, The DMC obtained a funding waiver from the Internal Revenue Service to defer the required funding of $10,241,000 for the 2003 plan year. The funding is amortized over a five-year period in accordance with the agreement with the Pension Benefit Guaranty Corporation (PBGC). The DMC was required to provide collateral to the PBGC in the form of a $1.5 million Letter of Credit and mortgages on a professional office building and the former Hutzel Hospital building in connection with the funding waiver. The Letter of Credit initially expired on December 31, 2007, however it is subject to annual renewals through 2009. In January, 2008 The DMC was released from the requirement to maintain the Letter of Credit and all the collateral.

On December 31, 2007, The DMC adopted the recognition provisions of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (FAS 158), which required The DMC to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of the pension plan in the December 31, 2007 consolidated balance sheet, with a corresponding adjustment to unrestricted net assets. The adjustment to unrestricted net assets at adoption represents the net unrecognized actuarial losses which were previously netted against The Detroit Medical Center's funded status in the consolidated balance sheets pursuant to the provisions of FAS 87. This amount will be subsequently recognized as net periodic pension cost pursuant to The DMC historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods will be recognized as a component of unrestricted net assets. These amounts will be subsequently recognized as a component of net periodic pension cost on the same basis as the amounts recognized in unrestricted net assets at adoption of FAS 158.

9. Retirement Benefits (continued)

The incremental effects of adopting the provisions of FAS 158 for the defined benefit retirement plan on the consolidated balance sheet at December 31, 2007 are presented in the following table. The adoption of FAS 158 had no effect on The DMC's excess of revenue over expenses for the year ended December 31, 2007, or for any prior period presented, and it will not affect the operating results in future periods.

	At December 31, 2007		
	Prior to Adopting FAS 158	**Effect of Adopting FAS 158**	**As Reported at December 31, 2007**
Prepaid pension liability	$59,565,000	$ (1,982,000)	$ 57,583,000
Decrease in unrestricted net assets	–	(1,982,000)	(1,982,000)

Included in unrestricted net assets at December 31, 2007 are unrecognized actuarial losses of $1,982,000 that have not yet been recognized in net periodic pension cost. The actuarial loss included in unrestricted net assets and expected to be recognized in net periodic pension cost during fiscal year ended December 31, 2008 is $0.

9. Retirement Benefits (continued)

The following table provides a reconciliation of the changes in the defined benefit plan's benefit obligation and fair value of assets for the years ended December 31, 2007 and 2006, and a statement of the funded status as of December 31, 2007 and 2006.

	Year Ended December 31 2007	2006
	(In Thousands)	
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of year	$ 869,082	$ 869,399
Service cost	–	118
Interest cost	50,157	49,494
Actuarial gain	(74,540)	(20,772)
Benefits paid	(30,720)	(29,157)
Curtailment gain	(2,159)	–
Benefit obligation at end of year	811,820	869,082
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	803,504	677,276
Actual gain on plan assets	59,720	96,144
Employer contributions	36,899	59,241
Benefits paid	(30,720)	(29,157)
Fair value of plan assets at end of year	869,403	803,504
Funded status at December 31	57,583	(65,578)
Unrecognized net actuarial loss	–	69,692
Unrecognized prior service credit	–	(2,160)
Additional minimum pension liability	–	(67,532)
Prepaid (accrued) retirement liability	$ 57,583	$ (65,578)

The accumulated benefit obligation for the defined benefit plans was $811,820,000 and $869,082,000 at December 31, 2007 and 2006, respectively.

Amounts recognized in the statements of financial position at December 31, 2007 consists of:

	December 31 2007	2006
	(In Thousands)	
Current portion of accrued retirement liability	$ –	$ (33,831)
Prepaid (accrued) retirement asset (liability)	57,583	(31,747)
Net prepaid (accrued) retirement asset (liability)	$ 57,583	$ (65,578)

9. Retirement Benefits (continued)

A summary of the components of net pension expense is as follows:

	Year Ended December 31	
	2007	2006
	(In Thousands)	
Service cost-benefits earned during the period	$ –	$ 118
Interest cost on projected benefit obligation	50,157	49,494
Expected return on assets	(68,710)	(59,183)
Amortization of prior service credit	–	(287)
Curtailment gain	(2,160)	–
Recognition of actuarial loss	–	3,611
Net retirement credit for defined benefit plan	(20,713)	(6,247)
Defined contribution plan expense	12,902	11,537
Total retirement expense (credit)	$ (7,811)	$ 5,290

The assumptions used to determine benefit obligations are as follows:

	December 31	
	2007	2006
Discount rate	6.60%	5.94%
Rate of increase in compensations levels	Frozen at 2003 level	Frozen at 2003 level
Measurement date	December 31	December 31

9. Retirement Benefits (continued)

The assumptions used to determine the net periodic benefit cost are as follows:

	Year Ended December 31	
	2007	**2006**
Discount rate	**5.94%**	5.88%
Expected long-term rate of return on assets	**8.50%**	8.50%
Rate of increase in compensation levels	**4.50%**	4.50%

To develop the expected long-term rate of return on assets assumption, The DMC considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested, and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

The DMC's pension plan weighted-average asset allocations by asset category are as follows:

	December 31	
	2007	**2006**
Asset category:		
Equity securities	**64%**	61%
Fixed income securities	**19%**	17%
Short-term securities	**5%**	6%
Limited partnerships	**12%**	16%

The plan assets are invested in separately managed portfolios using investment management firms. The plans' objective is to maximize total return without assuming undue risk exposure. The plan maintains a well-diversified asset allocation that best meets these objectives. Plan assets are largely comprised of equity securities, which include companies with all market capitalization sizes in addition to international and convertible securities. Debt securities include both intermediate and international securities.

Investments in derivative securities are not permitted for the sole purpose of speculating on the direction of market interest rates. Included in this prohibition are leveraging, shorting, swaps, futures, options, forwards, and similar strategies.

9. Retirement Benefits (continued)

In each investment account, investment managers are responsible to monitor and react to economic indicators, such as GDP, CPI, and the Federal Monetary Policy, that may affect the performance of their account. The performance of all managers and the aggregate asset allocation are formally reviewed on a quarterly basis, with a rebalancing of the asset allocation occurring at least once a year. The current asset allocation objective is to maintain 48% of plan assets in equity securities, 27% in fixed income securities, 20% in global asset allocation and 5% in alternative assets with each class allowing for a 10% deviation from the target.

Expected cash flows for the defined benefit retirement plan are as follows:

	Pension Benefits
	(In Thousands)
Expected employer contributions for the year ending December 31:	
2008	$ 9,361
Expected benefit payments for the year ending December 31:	
2008	$ 38,887
2009	41,561
2010	44,193
2011	46,817
2012	49,600
2013–2017	291,446

The expected employer contributions above represent amounts to be paid to the trust and the benefit payment amounts above represent total benefits expected to be paid from the trust.

10. Other Postretirement Employee Benefits

Certain DMC hospitals sponsor defined benefit health care plans for retirees who meet eligibility requirements, and one hospital has committed to continue postretirement health care benefits to certain union employees meeting certain age and service requirements. Additionally, two hospitals provide postretirement life insurance benefits to eligible employees and retirees.

10. Other Postretirement Employee Benefits (continued)

On December 8, 2003, the Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act introduces a prescription drug benefit under Medicare as well as a federal subsidy to certain sponsors of postretirement health care benefit plans that provide a prescription drug benefit to their enrollees that is at least actuarially equivalent to Medicare Part D. The DMC's estimate of its postretirement obligation, net periodic postretirement benefit cost, and the corresponding disclosures reflect the effect of the Act.

On December 31, 2007, DMC adopted the recognition provisions of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (FAS 158), which required The DMC to recognize the funded status (i.e., the difference between the fair value of plan assets and the accumulated benefit obligations) of its postretirement benefit plan in the December 31, 2007 consolidated balance sheet, with a corresponding adjustment to unrestricted net assets. The adjustment to unrestricted net assets at adoption represents the net unrecognized actuarial losses and unrecognized prior service costs, which were previously netted against The DMC funded status in the consolidated balance sheets pursuant to the provisions of FAS 106. These amounts will be subsequently recognized as net periodic postretirement benefit cost pursuant to The DMC historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic postretirement benefit plan cost in the same periods will be recognized as a component of unrestricted net assets. These amounts will be subsequently recognized as a component of net periodic postretirement benefit cost on the same basis as the amounts recognized in unrestricted net assets at adoption of FAS 158.

10. Other Postretirement Employee Benefits (continued)

The incremental effects of adopting the provisions of FAS 158 for the postretirement benefit plan on the consolidated balance sheet at December 31, 2007 are presented in the following table. The adoption of FAS 158 had no effect on The DMC excess of revenue over expenses for the year ended December 31, 2007, or for any prior period presented, and it will not affect the operating results in future periods.

	At December 31, 2007		
	Prior to Adopting FAS 158	Effect of Adopting FAS 158	As Reported at December 31, 2007
Accrued postretirement benefit liability	$ 14,185,000	$ (1,516,000)	$ 15,701,000
Decrease in unrestricted net assets	–	(1,516,000)	(1,516,000)

Included in unrestricted net assets at December 31, 2007 are an unrecognized prior service cost of $196,000 and unrecognized actuarial losses of $1,320,000 that have not yet been recognized in net periodic postretirement benefit cost. The prior service cost and actuarial loss included in unrestricted net assets and expected to be recognized in net periodic postretirement benefit cost during fiscal year ended December 31, 2008 is $63,000.

10. Other Postretirement Employee Benefits (continued)

The following table presents the amounts recognized for all the plans in the consolidated financial statements:

	Year Ended December 31 2007	2006
	(In Thousands)	
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of year	$ 23,672	$ 30,048
Service cost	1	1
Interest cost	1,164	1,401
Participant contributions	207	282
Actuarial gain	(4,193)	(5,764)
Benefits paid	(1,945)	(2,296)
Benefit obligation at end of year	18,906	23,672
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	3,123	3,017
Actual return on plan assets	119	143
Benefits paid from plan assets	(37)	(37)
Fair value of plan assets at end of year	3,205	3,123
Funded status at December 31	(15,701)	(20,549)
Unrecognized net actuarial loss	–	5,523
Unrecognized prior service cost	–	259
Accrued postretirement liability	$ (15,701)	$ (14,767)

Net periodic postretirement benefit cost includes the following components:

	Year Ended December 31 2007	2006
	(In Thousands)	
Service cost	$ 1	$ 1
Interest cost	1,164	1,401
Expected return on assets	(152)	(160)
Amortization of prior service cost	63	63
Amortization of unrecognized net actuarial loss	43	386
Net periodic postretirement benefit cost	$ 1,119	$ 1,691

10. Other Postretirement Employee Benefits (continued)

The weighted-average annual assumed rate of increase in the per capita cost of covered health care benefits (i.e., health care cost trend rate) is 11% for 2007 and is assumed to decrease 1% per year to 5% in 2013 and remain at that level thereafter. The weighted-average discount rate used in determining the accumulated postretirement obligation was 6.60% and 5.94% at December 31, 2007 and 2006, respectively. The weighted-average discount rate used in determining the net periodic postretirement benefit cost was 5.94% and 5.88% for the years ended December 31, 2007 and 2006, respectively. The DMC used a measurement date of December 31 in 2007 and 2006, to measure the obligations.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects:

	One-Percentage Point Increase	One-Percentage Point Decrease
	(In Thousands)	
Effect on total of service and interest cost components	$ 74	$ (63)
Effect on postretirement benefit obligation	1,233	(988)

Expected cash flows for the postretirement benefits are as follows (in thousands):

Expected benefit payments for the year ending December 31:	
2008	$ 2,098
2009	2,123
2010	2,134
2011	2,120
2012	2,071
2013–2017	8,855

The DMC funds the majority of the postretirement liability payments from operations.

11. Commitments and Contingencies

The DMC has entered into an information systems outsourcing arrangement with CareTech Corporation (an entity in which The DMC has a 30% equity interest). Under the agreement The DMC outsourced its entire information system operations for a 10-year period expiring December 31, 2011, with annual fees based on a budget approved annually. During the years ended December 31, 2007 and 2006, the expenses incurred under the outsourcing contract, excluding capital related items, were $57,099,000 and $54,916,000, respectively.

In 2007, the DMC entered into an outsourcing agreement with Cerner Corporation related to its clinical information systems. Under the agreement, The DMC has outsourced the operations and maintenance of its clinical information systems for a 10-year period expiring December 31, 2016. The annual fees range from $10,407,000 in 2008 to $16,890,000 in 2016. During the year ended December 31, 2007, the DMC paid $10,386,000 under the terms of the agreement. The majority of the costs incurred under the agreement are being accounted for on a straight-line basis over the life of the contract.

The DMC has an agreement with Provider HealthNet Services, Inc. (PHNS) to outsource medical record and transcription services of The DMC. The initial agreement was renegotiated in 2004, for a period of eight years ending May, 2012, with the option of five one-year renewal periods. The term of the medical records outsourcing agreement is eight years with contractually specified minimum annual payments over the term of the agreement. The contractual minimum payments aggregate $201,042,000 over the remaining term of the agreement. The DMC is contingently obligated should PHNS not achieve certain operating targets under The DMC agreement, which may require additional payments or extension of the contract. The DMC has the ability to terminate the agreement, subject to payment of certain penalty amounts. In connection with the initial outsourcing agreement, The DMC received a cash advance which was deferred and is being amortized over the term of the agreement and had a deferred balance of $2,782,000 and $4,101,000 at December 31, 2007 and 2006, respectively.

The DMC and its affiliates are parties to certain legal actions in addition to professional liability claims (see Note 8). Management believes the resolution of these matters will not materially affect the results of operations or the financial position of The DMC.

At December 31, 2007, The DMC had commitments of $14,126,000 for the purchase of property and equipment.

12. Functional Expenses

The DMC fulfills the health care requirements of residents in the community it serves by providing, as its principal function, a complete array of necessary health care services. Expenses classified by function are as follows:

	Year Ended December 31	
	2007	2006
	(In Thousands)	
Health care services	$ 1,637,689	$ 1,531,387
Teaching	83,817	128,763
General and administrative	165,479	156,582
	$ 1,886,985	$ 1,816,732

13. Related-Party Transactions

The DMC purchases teaching and clinical professional services from Wayne State University. Purchases for these services amounted to $76,455,000 and $74,850,000 for the years ended December 31, 2007 and 2006, respectively. During 2006, the DMC and Wayne State University agreed to the terms and conditions related to a long-term agreement. Under the agreement, Wayne State University will continue to provide services to the DMC for annual payments of approximately $76,000,000. In addition, the DMC may be required to pay an additional $9,000,000 in performance and incentive payments based on criteria developed by The DMC and Wayne State University on a departmental basis.

The DMC has transactions with other affiliated entities, board members, and related parties that are not significant.

14. Sale and Lease of Assets, and Revenue From Service and Facility Agreements

In December, 2005, The DMC completed the sale and lease of assets associated with the cancer service line at Harper-Hutzel Hospital to the Barbara Ann Karmanos Cancer Institute (KCI). Under the terms of the Asset Acquisition and Lease Agreement and related agreements, The DMC agreed to lease certain assets to KCI related to providing inpatient and outpatient cancer services.

The DMC transferred ownership of certain space to KCI in Harper-Hutzel Hospital through the establishment of condominium units which were sold to KCI.

In addition, The DMC leases an outpatient treatment center to KCI for a period of seven years, at which time ownership to the facility will be transferred to KCI. The lease requires annual payments of $824,000. KCI has the option to purchase the facility at the end of each lease year at predetermined amounts included in the lease. The lease has been accounted for as an operating lease at December 31, 2007 and 2006.

KCI also leases a radiation oncology center and equipment from The DMC. Under the terms of the ground lease with KCI, The DMC will receive payments of $720,000 annually for an initial term of 5 years and no payments will be received for the remaining 45 years of the initial lease term. The lease has been accounted for as an operating lease, and as such rental income is recognized ratably by The DMC over the lease term. In addition, The DMC leases radiation oncology equipment to KCI for a term of seven years. Payments under the lease are $824,000 annually. Under the terms of the agreement, title to the equipment transfers to KCI at the end of the lease term. The lease has been accounted for as a sales type lease based on the transfer of ownership.

The DMC also leases space to KCI in a professional office building. The initial term is five years, and the annual rental is $750,000. KCI also leases space in a parking facility from The DMC for an annual rental of $510,000. The initial term under the lease is ten years.

The DMC recognized rental income of $6,590,000 and $5,839,000 during the years ended December 31, 2007 and 2006, related to rental of the facilities to KCI.

14. Sale and Lease of Assets, and Revenue From Service and Facility Agreements (continued)

The following is a summary of the rental payments which will be received by The DMC over the following five years (in thousands):

Year ending December 31:	
2008	$ 3,631
2009	3,631
2010	3,631
2011	2,911
2012	2,911

Under the terms of the agreements, The DMC will provide certain ancillary clinical services, management services, and information technology services to KCI. The initial agreement is for a period of five years subject to various renewal options. These services are generally based on costs incurred by The DMC. At December 31, 2007 and 2006, The DMC had a receivable of $10,179,000 and $9,110,000 from KCI for services provided during the years ended December 31, 2007 and 2006. The statement of operations includes $61,238,000 and $76,849,000 related to revenue from service and facility agreements provided to KCI for the year ended December 31, 2007 and 2006, respectively.

15. Impairment Charge

During the years ended December 31, 2006 and 2005, Michigan Orthopedic Specialty Hospital incurred operating losses of $6,652,000 and $1,996,000, respectively. As a result of the operating losses incurred and projected loss for 2007, management performed a recoverability analysis and concluded that Michigan Orthopedic Specialty Hospital was impaired as the carrying amount of the facility exceeded the projected undiscounted cash flows related to the facility. In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, The DMC recognized an impairment charge of $1,814,000 to reduce the carrying value of the facility to its fair value. The fair value of the facility was determined based on an independent appraisal obtained by management. In addition, management determined that the carrying value of the goodwill recorded at the time of the hospital's acquisition was impaired, and therefore, recorded a charge of $2,184,000 to reduce the carrying value of the recorded goodwill.

16. Operating Results, Performance Improvement Plans and Liquidity Matters

The DMC has a working capital deficiency of $120,218,000 and $150,276,000 at December 31, 2007 and 2006, respectively. The decrease in the working capital deficiency is due to the additional funding of the pension plan in 2007. In addition, The DMC has a deficit in unrestricted net assets of $2,283,000 and $107,718,000 at December 31, 2007 and 2006, respectively. The financial position has resulted from insufficient payments for services rendered, historical declines in trends in patient volumes, continued provision of services to the uninsured, and the insolvency of certain managed care payors. However, based on current estimates of operating results, The DMC management believes that cash flow from operations, funds available from credit agreements, and funds designated for capital improvements and board-designated funds will be sufficient to finance both ongoing operations and required capital commitments for fiscal 2008.

17. Fourth Quarter Adjustments (Unaudited)

The DMC recorded adjustments in the fourth quarter of 2007 to decrease operating and nonoperating income related to unrealized losses of $1,400,000 of The DMC's trading portfolio which were reclassified from other changes in unrestricted net assets, as discussed in Note 1. In addition, the DMC recognized operating expenses of approximately $3,000,000 in the fourth quarter which should have been recognized in prior periods.