

**CONSOLIDATED FINANCIAL STATEMENTS AND
CONSOLIDATING FINANCIAL INFORMATION**

The Detroit Medical Center and Subsidiaries

Years Ended December 31, 2004 and 2003

With Report of Independent Auditors



The Detroit Medical Center and Subsidiaries

Consolidated Financial Statements and Consolidating Financial Information

Years Ended December 31, 2004 and 2003

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CONSOLIDATED FINANCIAL STATEMENTS

The Detroit Medical Center and Subsidiaries

Years Ended December 31, 2004 and 2003

With Report of Independent Auditors

The Detroit Medical Center and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2004 and 2003

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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, 2004 and 2003, 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 audit 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, 2004 and 2003, 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.

Ernst + Young LLP

March 4, 2005

The Detroit Medical Center and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 63,025	\$ 59,023
Net patient accounts receivable <i>(Note 3)</i>	111,186	121,849
Estimated third-party payor settlements <i>(Note 3)</i>	20,709	12,756
Other accounts receivable	29,258	26,725
Current portion of assets whose use is limited or restricted	5,404	6,478
Supplies	17,005	14,253
Assets held for sale	-	4,318
Prepaid expenses and other	25,080	21,774
Total current assets	271,667	267,176
Assets whose use is limited or restricted, less current portion <i>(Note 4)</i>:		
Board designated funds for capital improvements	30,972	30,526
Board designated funds for specific purposes	66,511	56,106
Professional liability funds	146,783	146,513
Funds held in trust under bond agreements <i>(Note 7)</i>	37,387	39,422
Endowment funds	60,055	56,368
Pledges receivable	17,231	22,106
Donor restricted funds	73,204	63,389
	432,143	414,430
Property and equipment, net <i>(Note 2)</i>	501,545	496,229
Other noncurrent assets <i>(Note 2)</i>	33,297	37,659
Total assets	\$ 1,238,652	\$ 1,215,494

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
Liabilities and net assets (deficit)		
Current liabilities:		
Accounts payable and accrued expenses	\$ 192,319	\$ 180,764
Accrued compensation and related amounts	45,963	49,147
Estimated third-party payor settlements <i>(Note 3)</i>	39,101	46,051
Advance payment from third-party payor	24,853	49,212
Current portion of long-term debt <i>(Note 7)</i>	15,635	12,144
Current portion of accrued retirement liability <i>(Note 9)</i>	1,168	4,542
Current portion of accrued professional liability losses <i>(Note 8)</i>	19,335	19,702
Total current liabilities	338,374	361,562
Long-term debt, less current portion <i>(Note 7)</i>	562,963	567,507
Other noncurrent liabilities, less current portion <i>(Notes 2, 8, 9, and 10)</i>	444,130	411,039
	1,007,093	978,546
Total liabilities	1,345,467	1,340,108
Net assets (deficit):		
Unrestricted		
Operations	(107,022)	(120,116)
Additional minimum pension liability	(150,286)	(142,463)
	(257,308)	(262,579)
Temporarily restricted	83,605	72,610
Permanently restricted	66,888	65,355
Total net assets (deficit)	(106,815)	(124,614)
Total liabilities and net assets (deficit)	\$ 1,238,652	\$ 1,215,494

See accompanying notes.

The Detroit Medical Center and Subsidiaries

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

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Unrestricted revenue and other support		
Net patient service revenue <i>(Note 3)</i>	\$ 1,665,379	\$ 1,510,969
Governmental subsidy <i>(Note 16)</i>	23,855	26,145
Other revenue	70,894	81,279
Net assets released from restrictions for operations	13,525	12,152
Total unrestricted revenue and other support	<u>1,773,653</u>	<u>1,630,545</u>
Expenses		
Salaries, wages, and benefits	689,770	697,155
Services, supplies, and other <i>(Note 13)</i>	732,265	691,946
Provision for uncollectible accounts	196,832	182,962
Professional liability insurance <i>(Note 8)</i>	39,969	37,756
Interest	33,090	33,605
Depreciation and amortization	78,960	94,009
	<u>1,770,886</u>	<u>1,737,433</u>
Income (loss) from operations before adjustment for impairment charge	2,767	(106,888)
Impairment charge <i>(Note 15)</i>	-	(148,276)
Income (loss) from operations, including adjustment for impairment charge	<u>2,767</u>	<u>(255,164)</u>
Other nonoperating expense:		
Investment loss and other	(309)	(3,290)
Excess of revenue over expenses (expenses over revenue)	<u>2,458</u>	<u>(258,454)</u>

Continued on next page.

The Detroit Medical Center and Subsidiaries

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

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Unrestricted net assets		
Excess of revenue over expenses (expenses over revenue)	\$ 2,458	\$ (258,454)
Discontinued operations <i>(Note 14)</i>	5,512	(8,274)
Change in unrealized gain/loss in fair value of investments	2,976	27,790
Net assets released from restrictions		
for long-lived assets	5,249	7,840
Change in additional minimum pension liability	(7,823)	32,223
Other changes	(3,101)	3,964
Increase (decrease) in unrestricted net assets	<u>5,271</u>	<u>(194,911)</u>
Temporarily restricted net assets		
Contributions	18,214	9,577
Investment income	7,923	2,235
Change in unrealized gain/loss in fair value of investments	5,007	19,770
Net assets released from restrictions		
for long-lived assets	(5,249)	(7,840)
Net assets released from restrictions for operations	(13,525)	(12,152)
Other changes	(1,375)	(4,016)
Increase in temporarily restricted net assets	<u>10,995</u>	<u>7,574</u>
Permanently restricted net assets		
Contributions	1,533	2,915
Other changes	-	51
Increase in permanently restricted net assets	<u>1,533</u>	<u>2,966</u>
Increase (decrease) in net assets	17,799	(184,371)
Net assets (deficit) at beginning of year	(124,614)	59,757
Net assets (deficit) at end of year	<u>\$ (106,815)</u>	<u>\$ (124,614)</u>

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Operating activities		
Increase (decrease) in net assets	\$ 17,799	\$ (184,371)
Adjustments to reconcile increase (decrease) in net assets to cash provided by operating activities:		
Depreciation and amortization	78,960	94,009
Provision for uncollectible accounts	196,832	182,962
Gain on sale of assets	(3,786)	
Impairment charges	-	148,276
Additional minimum pension liability <i>(Note 9)</i>	7,823	(32,223)
Increase in net unrealized gain/loss in fair value of investments	(8,606)	(47,560)
Changes in operating assets and liabilities:		
Patient accounts receivable	(186,169)	(153,699)
Estimated third party payor settlements	(7,953)	8,977
Other current assets	(8,591)	21,897
Accounts payable and accrued expenses	11,555	(13,862)
Other current liabilities	(3,184)	6,363
Due to third party payors	(6,950)	3,086
Advance from third-party payor	(24,359)	7,453
Accrued retirement liability	2,067	8,554
Accrued unfunded professional liability losses	14,215	(23,233)
Other operating activities	7,965	(1,605)
Cash provided by operating activities	<u>87,618</u>	<u>25,024</u>
Investing activities		
Purchase of property and equipment	(76,694)	(71,741)
Proceeds from sale of assets	13,625	-
(Increase) decrease in assets whose use is limited or restricted, excluding professional liability funds	(7,667)	109,620
Other investing activities	(15)	2,052
Cash (used in) provided by investing activities	<u>(70,751)</u>	<u>39,931</u>
Financing activities		
Repayment of long-term debt	(12,865)	(11,501)
Cash used in financing activities	<u>(12,865)</u>	<u>(11,501)</u>
Increase in cash and cash equivalents	4,002	53,454
Cash and cash equivalents at beginning of year	59,023	5,569
Cash and cash equivalents at end of year	<u>\$ 63,025</u>	<u>\$ 59,023</u>

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

1. Organization and Significant Accounting Policies

Organization

The Detroit Medical Center, a parent holding company, and its subsidiaries (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
- Children's Hospital of Michigan ^(A)
- Children's Choice of Michigan
- DMC Insurance Co., Ltd. (see Note 8)
- DMC Nursing Homes, Inc.
- 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 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. Effective September 1, 2003, The DMC assumed the remaining interest in DMC Care, a managed care contracting entity, and merged the entity into The DMC. The merger resulted in a \$2,147,000 increase in unrestricted net assets. The DMC accounts for its investment in CareTech Corporation using the equity method of accounting. All significant intercompany account balances and transactions have been eliminated in consolidation.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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 DSH 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 with readily determined fair values and all investments in debt securities are classified as nontrading and are measured, at fair value using quoted market prices. Realized gains and losses, including losses considered to be other-than-temporary, are included in excess of revenue over expenses (expenses over revenue). Unrealized gains and losses determined to be temporary are recorded as an addition to or deduction from net assets.

The DMC continually reviews its investments portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Factored into this evaluation are the general market conditions, the issuer's financial condition and near-term prospects, the recommendation of advisors, and the length of time and extent of time to which the market value has been less than cost.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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 cash advances from the Medicaid program related to medical education and indigent volume. The cash advances are recognized ratably as income.

Revenue from the Medicare and Medicaid programs accounted for approximately 24% and 24% in 2004, respectively; and 25% and 25% in 2003, 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 prior year activities. 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.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

The provision for bad debts is based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage and other collection indicators. Periodically throughout the year management assesses the adequacy of the allowance for uncollectible accounts based upon 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 receiving amounts due from insurance, The DMC follows established guidelines for placing certain past due patient balances with collection agencies.

Supplies

Supplies 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 lease, 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.

Other Noncurrent Assets

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

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.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

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 (Expenses Over Revenue)

The statement of operations and changes in net assets includes the excess of revenue over expenses (expenses over revenue). Changes in unrestricted net assets which are excluded from excess of revenue over expenses (expenses over revenue), consistent with industry practice, include unrealized gains and losses on investments (except those deemed to be other than temporary), additional minimum pension liability, results of discontinued operations, 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.

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 records impairment losses on long-lived assets used in operations when events and circumstances indicate that long-lived assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. The amount of the impairment is determined based on the fair market value of the asset.

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.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

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 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.

Reclassification

Certain 2003 amounts have been reclassified to conform with the 2004 presentation.

2. Additional Balance Sheet Information

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
Property and equipment:		
Land and land improvements	\$ 9,693	\$ 8,677
Buildings and improvements	795,327	732,777
Equipment	959,005	923,435
Construction in progress	33,673	59,871
	1,797,698	1,724,760
Accumulated depreciation	(1,296,153)	(1,228,531)
	\$ 501,545	\$ 496,229

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Additional Balance Sheet Information (continued)

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
Other noncurrent assets:		
Goodwill and other intangible assets	\$ 10,699	\$ 11,124
Accumulated amortization	<u>(5,315)</u>	<u>(4,769)</u>
	5,384	6,355
Deferred debt issuance costs, net of accumulated amortization	12,888	13,725
Deferred compensation investments	1,942	3,073
Investment in affiliates	5,498	7,003
Other	<u>7,585</u>	<u>7,503</u>
	<u>\$ 33,297</u>	<u>\$ 37,659</u>
Other noncurrent liabilities, less current portion:		
Accrued professional liability losses	\$ 169,836	\$ 154,888
Accrued retirement liability	232,626	219,362
Other postretirement liability	14,881	14,147
Deferred compensation liability	1,942	3,073
Other	<u>24,845</u>	<u>19,569</u>
	<u>\$ 444,130</u>	<u>\$ 411,039</u>

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue and Accounts Receivable

Net patient service revenue consists of the following:

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Gross revenue from services to patients	\$ 3,870,824	\$ 3,518,577
Contractual adjustments	(2,212,945)	(2,007,608)
Changes in estimate related to favorable prior year third-party payor settlements	7,500	--
Net patient service revenue	\$ 1,665,379	\$ 1,510,969

Net patient accounts receivable consists of the following:

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
Gross patient accounts receivable	\$ 652,884	\$ 562,904
Allowances and advances under contractual arrangements	(460,450)	(383,931)
Allowance for uncollectible accounts	(81,248)	(57,124)
	\$ 111,186	\$ 121,849

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, 2004 and 2003 include net amounts due from Medicare (13% and 14%), Medicaid (14% and 14%), Blue Cross (12% and 13%), and other payors, (61% and 59%), respectively.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments

Investments and cash and cash equivalents are summarized as follows:

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
Cash and cash equivalents	\$ 156,725	\$ 157,598
United States government and Foreign obligations	92,417	80,582
Corporate bonds	52,579	42,847
Common stock	179,195	172,892
Other	2,425	3,906
	\$ 483,341	\$ 457,825

Over the past several years, the public equity markets have experienced changes which impacted the investment portfolio held by The DMC. Management continually reviews the investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Factored into this evaluation are general market conditions, the issuer's financial condition and near-term prospect, conditions in the issuer's industry, the recommendation of advisors and the length of time and extent to which the market value has been less than cost. During the years ended December 31, 2004 and 2003, The DMC recorded a realized loss for other-than temporary declines in the fair value of investments of approximately \$365,000 and \$5,206,000, respectively, of which \$365,000 and \$2,093,000, respectively, is included in other non-operating expense and \$0 and \$3,113,000, respectively, is included in investment income on temporarily restricted net assets in the accompanying statements of operations and changes in net assets.

The gross unrealized gains (losses) on investments were \$33,203,000 and \$(1,714,000) at December 31, 2004 and \$27,177,000 and \$(3,671,000) at December 31, 2003. The following tables summarize the fair value of investments that have gross unrealized gains (the amount by which fair value exceeds historical cost) and gross unrealized losses (the amount by which historical cost exceeds fair value) as of December 31, 2004 and 2003. The tables further segregate the securities that have been in a gross unrealized gain or loss position as of December 31, 2004 and 2003, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months of \$910,000 are a reflection of the normal fluctuation of the stock market and are therefore considered temporary. The gross unrealized losses of twelve months or longer of \$804,000 represent an average 17% decline in fair value below cost. The decline in value is assessed by management to be temporary based on their assessment of projected recoveries in 2004.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments (continued)

The following tables summarize the unrealized gains and losses on investments held at December 31, 2004 and 2003:

Description of Securities	December 31, 2004					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Unrealized Gains (Losses)	Fair Value	Unrealized Gains (Losses)	Fair Value	Unrealized Gains (Losses)
	<i>(In Thousands)</i>					
Investments in loss position:						
Government obligations	\$ 33,290	\$ (63)	\$ 2,128	\$ (362)	\$ 35,418	\$ (425)
Corporate bonds	17,273	(27)	596	(259)	17,869	(286)
Subtotal, debt securities	50,563	(90)	2,724	(621)	53,287	(711)
Cash and equivalents	8	-	-	-	8	-
Common stock	11,973	(817)	1,211	(181)	13,184	(998)
Other investments	627	(3)	-	(2)	627	(5)
Total investments in loss position	63,171	(910)	3,935	(804)	67,106	(1,714)
Investments in gain position:						
Government obligations	35,799	1,242	51,319	2,195	87,118	3,437
Corporate bonds	16,916	680	17,794	1,920	34,710	2,600
Subtotal, debt securities	52,715	1,922	69,113	4,115	121,828	6,037
Cash and equivalents	124,546	194	1,506	1	126,052	195
Common stock	69,984	9,557	96,027	17,336	166,011	26,893
Other investments	2,343	67	1	11	2,344	78
Total investments in gain position	249,588	11,740	166,647	21,463	416,235	33,203
Totals	\$ 312,759	\$ 10,830	\$ 170,582	\$ 20,659	\$ 483,341	\$ 31,489

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments (continued)

Description of Securities	December 31, 2003					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Unrealized Gains (Losses)	Fair Value	Unrealized Gains (Losses)	Fair Value	Unrealized Gains (Losses)
	<i>(In Thousands)</i>					
Investments in loss position:						
Government obligations	\$ 17,747	\$ (113)	\$ 232	\$ (18)	\$ 17,979	\$ (131)
Corporate bonds	5,741	(31)	2,061	(19)	7,802	(50)
Subtotal, debt securities	23,488	(144)	2,293	(37)	25,781	(181)
Cash and equivalents	549	(703)	-	-	549	(703)
Common stock	6,399	(401)	55,068	(1,930)	61,467	(2,331)
Other investments	1,057	(456)	-	-	1,057	(456)
Total investments in loss position	31,493	(1,704)	57,361	(1,967)	88,854	(3,671)
Investments in gain position:						
Government obligations	36,796	702	25,807	2,636	62,603	3,338
Corporate bonds	23,017	1,527	12,028	1,392	35,045	2,919
Subtotal, debt securities	59,813	2,229	37,835	4,028	97,648	6,257
Cash and equivalents	156,905	952	144	11	157,049	963
Common stock	108,215	18,427	3,210	1,056	111,425	19,483
Other investments	1,767	337	1,082	137	2,849	474
Total investments in gain position	326,700	21,945	42,271	5,232	368,971	27,177
Totals	\$ 358,193	\$ 20,241	\$ 99,632	\$ 3,265	\$ 457,825	\$ 23,506

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments (continued)

Investment return is summarized as follows:

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Interest and dividends	\$ 3,432	\$ 7,256
Net realized gains	15,595	13,135
Other than temporary loss on investments	(365)	(5,206)
Change in net unrealized gain/loss	8,348	47,560
Total investment income	\$ 27,010	\$ 62,745
Included in other revenue	\$ 11,366	\$ 15,276
Included in other nonoperating (expense)	(262)	(2,326)
Reported separately as change in unrealized gain/loss	2,976	27,790
	14,080	40,740
Included in temporarily restricted investment income	7,923	2,235
Included in temporarily restricted unrealized gain	5,007	19,770
Total investment income	\$ 27,010	\$ 62,745

Investment return, excluding unrealized gains and losses, on board designated funds for capital improvements is included in other nonoperating income. All other investment return, excluding unrealized gains and losses in fair value of investments, which is not restricted by explicit donor stipulations, is included in other revenue.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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 sheet for cash and cash equivalents approximate fair value.

Assets whose use is limited: The fair values for marketable debt and equity securities, including assets whose use is limited or restricted, 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	
	2004	2003
	<i>(In Thousands)</i>	
Cash and cash equivalents	\$ 63,025	\$ 59,023
Current portion of assets whose use is limited	5,404	6,478
Assets whose use is limited or restricted, less current portion	414,912	392,324

The carrying amount and fair value of long-term debt are as follows:

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
Carrying amount	\$ 560,733	\$ 572,065
Fair value	563,935	509,635

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Credit Agreement

On June 30, 2004 The DMC and GE Capital executed an amended and restated credit agreement. Under the 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 uncollectible accounts. The credit agreement, which expires June 30, 2007, 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 achieve defined cash flow ratios. Interest on borrowings is based on the current LIBOR plus 2.75% (5.17% at December 31, 2004). In addition, The DMC is charged an unused facility fee equal to 0.375% of the unused liquidity facility. At December 31, 2004 and 2003, The DMC had no outstanding balance under the credit agreement; the credit agreement was not utilized during the year ended December 31, 2004 but was utilized at various amounts during the year ended December 31, 2003.

7. Long-Term Debt and Leases

Long-term debt consists of the following:

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
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	108,820	108,820
Series 1993B, interest at 4.80% to 5.75%, due 2023	120,950	124,655
Series 1995, interest at 6.0% to 6.7%, due 2026	38,735	40,155
Series 1997A, interest at 5.0% to 5.5%, due 2027	166,370	169,685
Series 1998A, interest at 5.0% to 5.25%, due 2028	108,650	108,650
Obligations under capital leases	17,865	7,586
Notes payable and other obligations	14,633	17,525
	578,598	579,651
Less current portion	15,635	12,144
	\$ 562,963	\$ 567,507

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt and Leases (continued)

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 \$8,440,000 in 2005 to \$37,585,000 in 2028.

Based on the results of operations for the year ended December 31, 2003, The DMC did not achieve an annual debt service coverage ratio of at least 1.10 as required by the Master Indentures. The debt service coverage ratio for the year ended December 31, 2003 was 0.77. Failure to achieve the minimum debt service coverage ratio may result in an Event of Default, if declared by the Master Indenture trustees or bond trustee. As a result of failure to achieve the required debt service coverage ratio, The DMC was required to engage a consultant to review the operations of The DMC and provide recommendations for improvements to increase net revenue, as defined, to the required level. The DMC retained a consultant to review its operations prior to December 31, 2003.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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. Under the terms of the Forbearance Agreements, the trustees have 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 1.0 at June 30, 2004, 1.1 at September 30, 2004, and 1.2 at December 31, 2004 and quarterly thereafter, maintain liquidity of \$65,000,000 and 15 days cash on hand at June 30, 2004 and December 31, 2004, and semi-annually thereafter, and provide quarterly compliance certificates. The DMC is required to comply with such covenants until such time as 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. If the DMC is unable to meet the provisions of the Forbearance Agreements, the DMC will be required to retain a consultant, acceptable to the trustee within 60 days. If The DMC fails to comply with the material recommendations of the consultant, or if the debt service coverage ratio falls below 1.00, the trustees may, by written notice to The DMC, declare an immediate event of default under the Master Indentures.

Loan agreements for the Series 1995 bonds require a debt coverage ratio of 140% of maximum total principal and interest which was not achieved in fiscal 2003. Among other requirements of the Series 1995 loan agreement, which debt was assumed from the 1997 acquisition of Sinai Hospital, The DMC is required to engage a consultant to make recommendations to cause net revenues, as defined, to be at least 140% of maximum total interest and principal requirements, whenever actual net revenues are less than 140% of principal and interest requirements. The DMC violated the covenant at December 31, 2003. Under the terms of the loan agreement, The DMC is required to retain a consultant to increase the net revenue, as defined, to the required level. As noted above, The DMC hired a consultant in November 2003 and believes it has remedied the noncompliance.

Portions of the proceeds of the Series 1988A, 1988B, 1991A, 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 \$15,565,000 at December 31, 2004, is considered to be extinguished for financial reporting purposes and will be paid from the escrow funds.

Interest paid was \$32,951,000 in 2004 and \$33,813,000 in 2003. In addition, the DMC capitalized interest of \$843,000 in 2004 and \$1,123,000 in 2003.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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
	<i>(In Thousands)</i>	
2005	\$ 12,498	\$ 4,557
2006	14,588	4,518
2007	14,034	4,314
2008	14,465	4,227
2009	13,857	3,301
Thereafter	491,291	1,238
	\$ 560,733	22,155
Less amounts representing interest		4,290
		\$ 17,865

Rent expense incurred under operating leases were \$18,741,000 in 2004 and \$17,998,000 in 2003.

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. Under several of these insurance programs, a portion of the risk of loss from professional liability claims is retained by the subsidiary. 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 Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Professional and General Liability Claims (continued)

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.

Accrued professional liability losses are recorded at their estimated present value based on discount rates, which average approximately 6% in 2004 and 2003. Professional liability expense was \$40,417,000 in 2004 and \$38,117,000 in 2003.

9. Retirement Benefits

The DMC 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 DMC also provides various defined contribution plans to employees. The benefits under the defined benefit plan are based in general on years of service and final average earnings.

In April 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 for 2003. As a result of the change in pension benefits, The DMC recognized a curtailment gain of \$88,366,000, which reduced the projected benefit obligation at December 31, 2003.

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 expires on December 31, 2005, and is subject to annual renewals through 2009.

On April 27, 2004, the Board of Trustees approved the adoption of a new 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 plan during the year. Total expense under the plan was \$11,186,000 in 2004 and \$1,660,000 in 2003.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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, 2004 and 2003, and a statement of the funded status as of December 31, 2004 and 2003.

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of year	\$ 839,518	\$ 832,241
Service cost	2,216	6,513
Interest cost	51,074	51,367
Actuarial loss	18,799	61,680
Benefits paid	(25,580)	(23,917)
Curtailment gain	-	(88,366)
Benefit obligation at end of year	886,027	839,518
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	601,158	482,498
Actual gain on plan assets	60,798	120,951
Employer contributions	4,542	21,626
Benefits paid	(25,580)	(23,917)
Fair value of plan assets at end of year	640,918	601,158
Funded status at December 31	(245,109)	(238,360)
Unrecognized net actuarial loss	164,335	159,941
Unrecognized prior service credit	(2,734)	(3,022)
Additional minimum pension liability	(150,286)	(142,463)
Accrued retirement liability	\$ (233,794)	\$ (223,904)

The change in the projected benefit obligation in 2004 and 2003 was principally due to the decrease in the discount rate and the curtailment gain in 2003. The accumulated benefit obligation for the defined benefit plans was \$874,712,000 and \$825,062,000 at December 31, 2004 and 2003, respectively.

The Detroit Medical Center and Subsidiaries
Notes to Consolidated Financial Statements (continued)

9. Retirement Benefits (continued)

Amounts recognized in the statements of financial position consists of:

	December 31	
	2004	2003
	<i>(In Thousands)</i>	
Current portion of accrued retirement liability	\$ (1,168)	\$ (4,542)
Accrued retirement liability	(232,626)	(219,362)
Net accrued retirement liability	\$ (233,794)	\$ (223,904)

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

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Service cost-benefits earned during the period	\$ 2,216	\$ 6,513
Interest cost on projected benefit obligation	51,073	51,367
Expected return on assets	(53,335)	(43,028)
Amortization of prior service credit	(287)	(287)
Recognition of actuarial loss	6,942	13,456
Net retirement expense of defined benefit plan	6,609	28,021
Other retirement plan expense	11,186	1,660
Net retirement expense	\$ 17,795	\$ 29,681

The Detroit Medical Center and Subsidiaries
Notes to Consolidated Financial Statements (continued)

9. Retirement Benefits (continued)

The assumptions used to determine benefit obligations at December 31 are as follows:

	December 31	
	2004	2003
Discount rate	6.00%	6.25%
Rate of increase in compensation levels	4.50%	4.50%
Measurement date	December 31 December 31	

The assumptions used to determine the net periodic benefit cost for the years ended December 31 are as follows:

	Years Ended December 31	
	2004	2003
Discount rate	6.25%	6.75%
Expected long-term rate of return on assets	9.00%	9.25%
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 Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Retirement Benefits (continued)

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

Asset category:	December 31	
	2004	2003
Equity securities	73%	71%
Fixed income securities	23%	25%
Short term securities	4%	4%

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.

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 60% of plan assets in equity securities, and 40% in fixed income securities, with both classes allowing for a 10% deviation from the target.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Retirement Benefits (continued)

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

	Pension Benefits
	<u>(In Thousands)</u>
Expected employer contributions for the year ending December 31:	
2005	\$ 1,168
Expected benefit payments for the year ending December 31:	
2005	\$ 30,295
2006	31,741
2007	33,312
2008	34,691
2009	36,690
2010 – 2014	220,263

The expected employer contribution amounts above represent amounts to be paid to the trust. 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 active employees meeting certain age and service requirements. Additionally, two hospitals provide postretirement life insurance benefits to eligible employees and retirees.

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. The Hospital believes its postretirement benefit plan may qualify for subsidy under the Act.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Other Postretirement Employee Benefits (continued)

In accordance with FASB Staff Position 106-1, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*, the accumulated postretirement benefit obligation and net periodic postretirement benefit cost do not reflect an effect of the Act as The DMC has elected to defer the accounting for the impact of the Act until pending authoritative guidance is issued. Once issued, such authoritative literature may require The DMC to modify previously reported information.

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

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of year	\$ 31,276	\$ 25,126
Service cost	5	4
Interest cost	1,918	1,983
Participant contributions	323	1,396
Actuarial loss	1,187	6,645
Benefits paid	(2,331)	(3,878)
Benefit obligation at end of year	32,378	31,276
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	2,904	2,794
Actual return on plan assets	128	147
Benefits paid from plan assets	(33)	(37)
Fair value of plan assets at end of year	2,999	2,904
Funded status at December 31	(29,379)	(28,372)
Unrecognized net actuarial loss	14,114	13,778
Unrecognized prior service cost	384	447
Accrued postretirement liability	\$ (14,881)	\$ (14,147)

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Other Postretirement Employee Benefits (continued)

Net periodic postretirement benefit cost includes the following components:

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Service cost	\$ 5	\$ 4
Interest cost	1,918	1,983
Expected return on assets	(160)	(160)
Amortization of prior service cost	63	63
Amortization of unrecognized net actuarial loss	883	833
Net periodic postretirement benefit cost	<u>\$ 2,709</u>	<u>\$ 2,723</u>

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 2004 and is assumed to decrease 1% per year to 5% in 2010 and remain at that level thereafter. The weighted-average discount rate used in determining the accumulated postretirement obligation was 6.00% and 6.25% at December 31, 2004 and 2003, respectively. The weighted-average discount rate used in determining the net periodic postretirement benefit cost was 6.25% and 6.75% for the years ended December 31, 2004 and 2003, respectively. The DMC used a measurement date of December 31 in 2004 and 2003 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
		<i>(In Thousands)</i>
Effect on total of service and interest cost components	\$ 118	\$ (156)
Effect on postretirement benefit obligation	2,132	(2,465)

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Other Postretirement Employee Benefits (continued)

Expected cash flows for the post retirement benefits are as follows:

Expected benefit payments for the year ending December 31:	
2005	\$ 2,795
2006	2,927
2007	3,040
2008	3,004
2009	3,007
2010 – 2014	14,084

The DMC funds the majority of the postretirement liability expenses 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 33% 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, 2004 and 2003, the fees paid under the outsourcing contract, excluding capital related items, were \$42,823,000 and \$59,431,000, respectively.

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 medical records outsourcing is represented by a eight year contractual commitment with contractually specified minimums over the term of the agreement. The contractual minimums aggregate \$311,320,000 over the remaining term of the agreement to include medical record and transcription services,. 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 of \$13,325,000 which was deferred and is being amortized over the term of the agreement and had a balance of \$6,739,000 and \$10,676,000 at December 31, 2004 and 2003, respectively.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Commitments and Contingencies (continued)

The DMC and its affiliates are parties to certain legal actions other than professional liability claims. 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, 2004, The DMC had commitments of \$19,908,000 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, excluding discontinued operations, impairment costs, and changes in estimate, classified by function are as follows:

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Health care services	\$ 1,448,649	\$ 1,438,489
Teaching	130,600	121,282
General and administrative	191,637	177,662
	<u>\$ 1,770,886</u>	<u>\$ 1,737,433</u>

13. Related-Party Transactions

The DMC purchases teaching and clinical professional services from Wayne State University. Purchases for these services amounted to \$79,900,000 and \$79,000,000 for the years ended December 31, 2004 and 2003, respectively.

The DMC has transactions with other affiliated entities, board members, and related parties that are not significant. The DMC believes that each of its related party transactions are on terms comparable to those that would be available from unaffiliated third parties.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Discontinued Operations

In 2003, The DMC reached an agreement with two independent parties to purchase the assets of two nursing homes owned and operated by The DMC. Management completed the sale of the nursing homes during April and May of 2004. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the nursing homes were considered "assets held for sale" at December 31, 2003. Based on the expected selling price of the facilities, management determined that no impairment charge was required at December 31, 2003 as the fair value less costs to sell exceeded the carrying value of the assets.

The operations of the nursing homes are considered discontinued operations in accordance with SFAS No. 144. Accordingly, the following amounts have been included in discontinued operations on the statements of operations and changes in net assets for the years ended December 31, 2004 and 2003:

	Years Ended December 31	
	2004	2003
	<i>(In Thousands)</i>	
Total revenue	\$ 8,163	\$ 21,274
Total expenses	9,267	29,548
Loss from operations	(1,104)	(8,274)
Gain on sale of facilities	6,616	—
Net income (loss)	\$ 5,512	\$ (8,274)

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Impairment Charges

During 2003, The DMC completed plans to privatize the physicians in its primary care network. Under the privatization plan, certain physician employment arrangements were terminated and those physicians either purchased the ambulatory site or entered into a lease for each of the ambulatory sites. The leases have an initial term of five years with a five-year renewal option. Management determined the long-lived assets associated with several of the primary care network sites were impaired due to carrying value of the long-lived assets exceeding the undiscounted cash flows to be received under the terms of the sale agreement or lease agreements. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* the ambulatory sites were considered as "assets held for sale" and the carrying value of the building, improvements and fixed equipment was permanently adjusted. Fair value was determined based on independent appraisals. The DMC recognized an impairment loss related to the ambulatory sites of \$297,000 in 2003 to reduce the carrying value of the assets to fair value. During 2004, The DMC completed the privatization plan for the facilities for net proceeds of approximately \$2,692,000, which approximated the recorded net book value at the date of sale.

During the year ended December 31, 2003 Harper-Hutzel Hospital incurred operating losses of \$37,943,000. As a result of the significant operating losses incurred and projected loss for 2004, management performed a recoverability analysis and concluded that Harper-Hutzel 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 \$147,979,000 to reduce the carrying value of the facility of approximately \$205,000,000 to its fair value. The fair value of the facility was determined based on an independent appraisal obtained by management.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

16. Operating Results, Performance Improvement Plans and Liquidity Matters

The DMC has a working capital deficiency of \$66,707,000 and \$94,386,000 at December 31, 2004 and 2003, respectively. In addition, The DMC has a deficit in unrestricted net assets of \$257,308,000 and \$262,579,000 at December 31, 2004 and 2003, 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 2005 and meet the additional requirements of the 2003 Forbearance Agreements.

During 2003, management pursued additional funding from government sources, including the City of Detroit, Wayne County, the State of Michigan and the Federal Government. The DMC entered into a Memorandum of Understanding (Memorandum) effective August 1, 2003, with the City of Detroit, Wayne County and the State of Michigan and a Temporary Oversight Committee (TOC) was formed to monitor The DMC's operations. Under the terms of the Memorandum, The DMC obtained \$50 million in funding from these agencies over a ten-month period as part of an emergency supplemental funding package to support the operations of Detroit Receiving Hospital and University Health Center, and Hutzel Hospital. For the years ended December 31, 2004 and 2003, total revenue includes \$23,855,000 and \$26,145,000, respectively; related to the supplemental funding package. At December 31, 2003, The DMC had recorded a receivable of \$12,235,000 for amounts due under the supplemental funding package.

Consolidating Financial Information

**Report of Independent Auditors on
Consolidating Financial Information**

**The Board of Trustees
The Detroit Medical Center**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating balance sheet and consolidating statement of operations are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Ernst & Young LLP

March 4, 2005

The Detroit Medical Center
Consolidating Balance Sheet

December 31, 2004
(In Thousands)

Assets	Consolidated Total	Consolidating Adjustments	Obligated Group	Non-Obligated Group
Current assets:				
Cash and cash equivalents	\$ 63,025	\$ -	\$ 59,016	\$ 4,009
Net patient accounts receivable	111,186	-	109,908	1,278
Estimated third-party payor settlements	20,709	-	20,709	-
Other accounts receivable	29,258	(3,854)	25,709	7,403
Current portion of assets whose use is limited or restricted	5,404	-	5,404	-
Supplies	17,005	-	16,378	627
Prepaid expenses and other	25,080	-	20,476	4,604
Total current assets	271,667	(3,854)	257,600	17,921
Assets whose use is limited or restricted, less current portion:				
Board designated funds for capital improvements	30,972	-	30,503	469
Board designated funds for specific purposes	66,511	-	62,999	3,512
Professional liability funds	146,783	-	-	146,783
Funds held in trust under bond agreements	37,387	-	37,383	4
Endowment funds	60,055	-	60,055	-
Pledges receivable	17,231	-	17,231	-
Donor restricted funds	73,204	-	73,204	-
	432,143	-	281,375	150,768
Property and equipment	501,545	-	491,983	9,562
Other noncurrent assets	33,297	(4,338)	26,668	10,967
Total assets	\$ 1,238,652	\$ (8,192)	\$ 1,057,626	\$ 189,218

	Consolidated Total	Consolidating Adjustments	Obligated Group	Non-Obligated Group
Liabilities and net assets (deficit)				
Current liabilities:				
Accounts payable and accrued expenses	\$ 192,319	\$ (3,852)	\$ 180,899	\$ 15,272
Accrued compensation and related amounts	45,963	-	44,929	1,034
Estimated third-party payor settlements	39,101	-	39,101	-
Advance from third-party payor	24,853	-	24,853	-
Current portion of long-term debt	15,635	(44)	14,866	813
Current portion of accrued pension liability	1,168	-	1,168	-
Current portion of accrued professional liability losses	19,335	-	18,158	1,177
Total current liabilities	338,374	(3,896)	323,974	18,296
Long-term debt, less current portion	562,963	-	548,506	14,457
Other noncurrent liabilities, less current portion	444,130	-	291,961	152,169
	<u>1,007,093</u>	<u>-</u>	<u>840,467</u>	<u>166,626</u>
Total liabilities	1,345,467	(3,896)	1,164,441	184,922
Net assets (deficit):				
Unrestricted	(107,022)	(4,296)	(112,612)	9,886
Additional minimum pension liability	(150,286)	-	(144,696)	(5,590)
	<u>(257,308)</u>	<u>(4,296)</u>	<u>(257,308)</u>	<u>4,296</u>
Temporarily restricted	83,605	-	83,605	-
Permanently restricted	66,888	-	66,888	-
Total net assets (deficit)	(106,815)	(4,296)	(106,815)	4,296
 Total liabilities and net assets (deficit)	 \$ 1,238,652	 \$ (8,192)	 \$ 1,057,626	 \$ 189,218

The Detroit Medical Center
Consolidating Statement of Operations (Deficit)

Year Ended December 31, 2004
(In Thousands)

	Consolidated Total	Consolidating Adjustments	Obligated Group	Non-Obligated Group
Unrestricted revenue and other support				
Net patient service revenue	\$ 1,665,379	\$ (8,815)	\$ 1,633,712	\$ 40,482
Governmental subsidy	23,855	-	23,855	
Other revenue	70,894	(56,036)	68,870	58,060
Net assets released from restrictions for operations	13,525	-	13,525	-
Total unrestricted revenue and other support	1,773,653	(64,851)	1,739,962	98,542
Expenses				
Salaries, wages, and benefits	689,770	-	683,342	6,428
Services, supplies, and other	732,265	(47,578)	700,379	79,464
Provision for uncollectible accounts	196,832	-	196,744	88
Professional liability insurance	39,969	(14,370)	39,052	15,287
Interest	33,090	(2,903)	31,863	4,130
Depreciation and amortization	78,960	-	77,275	1,685
Total expenses	1,770,886	(64,851)	1,728,655	107,082
Income/(loss) from operations	2,767	-	11,307	(8,540)
Other nonoperating income (expense):				
Investment (loss) income and other	(309)	-	(482)	173
Equity (deficit) in net assets of subsidiaries	-	8,367	(8,367)	-
Excess of revenue over expenses	2,458	8,367	2,458	(8,367)
Other changes in unrestricted net assets:				
Discontinued operations	5,512	-	-	5,512
Change in unrealized loss in fair value of investments	2,976	-	2,786	190
Net assets released from restrictions for long-lived assets	5,249	-	5,189	60
Change in additional minimum pension liability	(7,823)	-	(7,823)	-
Equity in net assets of subsidiaries	-	(5,512)	5,512	
Transfer to affiliate	-	-	(6,439)	6,439
Other changes	(3,101)	(6,689)	3,588	-
Increase (decrease) in unrestricted net assets	\$ 5,271	\$ (3,834)	\$ 5,271	\$ 3,834