Consolidated Financial Statements and Consolidating Financial Information

The Detroit Medical Center and Subsidiaries

Years ended December 31, 2002 and 2001
with Report of Independent Auditors

0212-0373943

EXHIBIT

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The Detroit Medical Center and Subsidiaries

Consolidated Financial Statements
and Consolidating Financial Information

Years ended December 31, 2002 and 2001

Contents

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Report of Independent Auditors

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, 2002 and 2001, and the related consolidated statements of operations and changes in net assets, 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Detroit Medical Center and subsidiaries at December 31, 2002 and 2001, and the consolidated results of their operations, changes in net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

May 23, 2003, except for Notes 6 and 16,
as to which the date is June 23, 2003

The Detroit Medical Center and Subsidiaries

Consolidated Balance Sheets

	December 31 2002	December 31 2001
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 5,569**	$ 34,886
Net patient accounts receivable *(Note 3)*	**151,112**	124,358
Estimated third-party payor settlements *(Note 3)*	**21,733**	39,753
Other accounts receivable	**47,191**	43,302
Current portion of assets whose use is limited or restricted	**5,645**	5,712
Supplies	**15,558**	14,734
Prepaid expenses and other	**21,900**	24,035
Total current assets	**268,708**	286,780
Assets whose use is limited or restricted, less current portion *(Note 4)*:		
Board designated funds for capital improvements	**110,641**	168,114
Board designated funds for specific purposes	**41,761**	48,959
Professional liability funds	**123,147**	114,254
Funds held in trust under bond agreements *(Note 7)*	**44,116**	53,026
Endowment funds	**54,640**	54,167
Pledges receivable	**23,476**	28,044
Donor restricted funds	**49,323**	66,071
	447,104	532,635
Property and equipment, net *(Note 2)*	**672,854**	640,811
Other noncurrent assets *(Note 2)*	**61,621**	53,356
Total assets	**$ 1,450,287**	$ 1,513,582

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	December 31	
	2002	2001
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	$ 212,195	$ 180,332
Accrued compensation and related amounts	42,784	41,865
Estimated third-party payor settlements *(Note 3)*	42,965	61,145
Advance payment from third-party payor	41,759	35,296
Current portion of long-term debt *(Note 7)*	10,876	9,196
Current portion of accrued retirement liability	33,747	-
Current portion of accrued professional liability losses	19,471	16,932
Total current liabilities	403,797	344,766
Long-term debt, less current portion *(Note 7)*	580,276	582,333
Other noncurrent liabilities, less current portion *(Notes 2, 8, 9 and 10)*	406,457	230,557
	986,733	812,890
Total liabilities	1,390,530	1,157,656
Net assets (deficit):		
Unrestricted		
Operations	107,018	207,641
Additional minimum pension liability	(174,686)	-
	(67,668)	207,641
Temporarily restricted	65,036	86,307
Permanently restricted	62,389	61,978
	59,757	355,926
Total liabilities and net assets	$ 1,450,287	$ 1,513,582

See accompanying notes.

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The Detroit Medical Center and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Years ended December 31 2002	2001
	(In Thousands)	
Unrestricted revenue and other support		
Net patient service revenue *(Note 3)*	$ 1,554,510	$ 1,532,568
Other revenue	59,211	77,552
Net assets released from restrictions for operations	10,622	18,296
Total unrestricted revenue and other support	1,624,343	1,628,416
Expenses		
Salaries, wages and benefits	694,136	653,525
Services, supplies and other (*Note 13*)	684,056	644,081
Provision for uncollectible accounts	169,953	181,276
Professional liability insurance *(Note 8)*	41,547	23,096
Interest	33,714	36,096
Depreciation and amortization	97,428	96,278
	1,720,834	1,634,352
Loss from operations before adjustment for managed care payors and impairment charge	(96,491)	(5,936)
Recovery (write-off) related to insolvency of managed care payor *(Note 3)*	9,540	(55,306)
Settlement with managed care payor *(Note 3)*	-	(7,562)
Impairment charge *(Note 14)*	(4,998)	-
Loss from operations	(91,949)	(68,804)
Other income (expense):		
Investment (loss) income	(8,694)	4,309
Closed facility expense	(1,508)	(5,314)
Gain on sale of assets	-	3,895
Excess of expenses over revenue	(102,151)	(65,914)

Continued on next page.

The Detroit Medical Center and Subsidiaries

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

	Years ended December 31	
	2002	2001
	(In Thousands)	
Unrestricted net assets		
Excess of expenses over revenue	$ (102,151)	$ (65,914)
Unrealized loss in fair value of investments	(7,531)	(12,108)
Net assets released from restrictions for long-lived assets	12,504	20,440
Additional minimum retirement liability	(174,686)	-
Other changes	(3,445)	(4,984)
Decrease in unrestricted net assets	(275,309)	(62,566)
Temporarily restricted net assets		
Contributions	17,138	29,188
Investment (loss) income	(5,071)	381
Unrealized loss in fair value of investments	(4,589)	(2,992)
Net assets released from restrictions for long-lived assets	(12,504)	(20,440)
Net assets released from restrictions for operations	(10,622)	(18,296)
Other changes	(5,623)	(3,484)
Decrease in temporarily restricted net assets	(21,271)	(15,643)
Permanently restricted net assets		
Contributions	411	5,152
Other changes	-	2,408
Increase in permanently restricted net assets	411	7,560
Decrease in net assets	(296,169)	(70,649)
Net assets at beginning of year	355,926	426,575
Net assets at end of year	$ 59,757	$ 355,926

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Years ended December 31 2002	2001
	(In Thousands)	
Operating activities		
Decrease in net assets	$ (296,169)	$ (70,649)
Adjustments to reconcile decrease in net assets to cash provided by operating activities:		
Depreciation and amortization	97,428	96,278
Provision for uncollectible accounts	169,953	181,276
Gain on sale of assets	-	(3,895)
Impairment charges	4,998	-
Additional minimum retirement liability *(Note 9)*	174,686	-
Increase in net unrealized loss in fair value of investments	12,120	15,100
Changes in operating assets and liabilities:		
Patient accounts receivable	(196,707)	(154,381)
Third party payor settlements	18,020	(17,826)
Other current assets	(2,328)	(11,500)
Accounts payable and accrued expenses	28,508	25,213
Other current liabilities	286	(2,903)
Due to third-party payors	(18,180)	9,746
Advance from third-party payor	6,463	(22,336)
Accrued pension costs	24,574	14,547
Accrued unfunded professional liability losses	(1,974)	(18,082)
Other operating activities	(4,689)	(8,530)
Cash provided by operating activities	16,989	32,058
Investing activities		
Purchase of property and equipment	(130,127)	(77,507)
Acquisition of Madison Community Hospital	(3,001)	-
Decrease in assets whose use is limited or restricted, excluding professional liability funds	79,268	19,039
Proceeds from sale of assets	13,325	4,046
Other investing activities	3,626	2,287
Cash used in investing activities	(36,909)	(52,135)
Financing activities		
Proceeds from long-term borrowings	-	14,655
Repayment of long-term debt	(9,397)	(7,445)
Cash (used in) provided by financing activities	(9,397)	7,210
Decrease in cash and cash equivalents	(29,317)	(12,867)
Cash and cash equivalents at beginning of year	34,886	47,753
Cash and cash equivalents at end of year	$ 5,569	$ 34,886

See accompanying notes.

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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 9)
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. The DMC accounts for its investments in CareTech Corporation, Caymich Insurance Company, Premier Purchasing Partners, L.P., and DMC Care 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 healthcare 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. Public mission support was approximately $109,273,000 (unaudited) and $113,554,000 (unaudited) for years ended December 31, 2002 and 2001, respectively.

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 non-trading and are measured, at fair value using quoted market prices. Gains and losses are included in excess of expenses over revenue. Unrealized gains and losses determined to be temporary are recorded as an addition to or deduction from net assets.

1. Organization and Significant Accounting Policies (continued)

During 2001 and 2002, the public equity markets experienced significant declines, which impacted investments held by The DMC. Management continually reviews its investment 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 to which the market value has been less than cost. At December 31, 2002, The DMC recorded a provision for other-than-temporary declines in the fair value of unrestricted investments of approximately $10,255,000, of which $3,381,000 was recorded as an unrestricted investment loss and $6,874,000 was recorded as an investment loss on temporarily restricted funds.

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 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 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.

1. Organization and Significant Accounting Policies (continued)

Revenue from the Medicare and Medicaid programs accounted for approximately 25% and 22%, respectively, of net patient service revenues for 2002. 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.

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.

Amortization of Other Noncurrent Assets

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 operating purposes and are included in unrestricted revenues and other support, whereas net assets released from restrictions for long-lived assets are reported as an other increase in unrestricted net assets. Pledges are recorded as increases in net assets when the pledge is made.

Permanently restricted net assets have been restricted by donors to be maintained by The DMC in perpetuity or for terms restricted by donor.

1. Organization and Significant Accounting Policies (continued)

Excess (Deficiency) of Revenue Over Expenses

The statement of operations and changes in net assets includes the excess of expenses over revenue. Changes in unrestricted net assets which are excluded from excess of 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 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 and Other Intangible Assets

In accordance with 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. At December 31, 2002, events and circumstances indicated that $200 million of assets related to Harper-Hutzel Hospital might be impaired. However, The DMC's estimate at December 31, 2002 of future undiscounted cash flows indicated that such carrying amounts were expected to be recovered. Nonetheless, it is reasonably possible that the estimate of undiscounted cash flows may change in the near term resulting in the need to write down those assets to fair value.

On May 20, 2003 the Board of Trustees approved management's consolidation plan for the partial closure of Detroit Receiving Hospital and University Health Center (DRHUHC) (see Note 16). The plan includes provision for the transfer of certain services from DRHUHC to Harper-Hutzel Hospital. As a result of the consolidation plan, the DRHUHC facility with a net book value of approximately $65 million at December 31, 2002 will be evaluated for impairment and The DMC anticipates an impairment charge in the range of $60,000,000 (unaudited) to $65,000,000 (unaudited) will be recorded in 2003.

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©(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.

Reclassification

Certain 2001 amounts have been reclassified to conform with the 2002 presentation.

2. Additional Balance Sheet Information

	December 31	
	2002	**2001**
	(In Thousands)	
Property and equipment:		
Land and land improvements	$ 13,434	$ 13,198
Buildings and improvements	1,004,838	935,567
Equipment	701,155	684,291
Construction in progress	78,860	51,468
	1,798,287	1,684,524
Accumulated depreciation	(1,125,433)	(1,043,713)
	$ 672,854	$ 640,811

2. Additional Balance Sheet Information (continued)

	December 31 2002	December 31 2001
	(In Thousands)	
Other noncurrent assets:		
Goodwill and other intangible assets	$ 12,125	$ 7,000
Accumulated amortization	(3,731)	(3,029)
	8,394	3,971
Deferred debt issuance costs	14,567	15,411
Deferred compensation investments	9,594	11,489
Investment in affiliates	10,039	8,610
Other	19,027	13,875
	$ 61,621	$ 53,356
Other noncurrent liabilities, less current portion:		
Accrued professional liability losses	$ 148,133	$ 146,856
Accrued pension costs	215,986	50,473
Other postretirement liability	13,870	14,229
Deferred compensation liability	9,594	11,489
Other	18,874	7,510
	$ 406,457	$ 230,557

3. Net Patient Service Revenue and Accounts Receivable

Net patient service revenue consists of the following:

	Years ended December 31 2002	Years ended December 31 2001
	(In Thousands)	
Gross revenue from services to patients	$ 3,076,326	$ 2,889,455
Contractual adjustments	(1,549,716)	(1,392,094)
Changes in estimate related to favorable third party payor prior year settlements	7,900	35,207
Net patient service revenue	$ 1,554,510	$ 1,532,568

3. Net Patient Service Revenue and Accounts Receivable (continued)

Net patient accounts receivable consists of the following:

	December 31	
	2002	2001
	(In Thousands)	
Net patient accounts receivable:		
Gross patient accounts receivable	$ 546,787	$ 565,679
Allowances and advances under contractual arrangements	(331,542)	(364,274)
Allowance for uncollectible accounts	(64,133)	(77,047)
	$ 151,112	$ 124,358

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, 2002 and 2001 include net amounts due from Medicare (13% and 11%), Medicaid (17% and 14%), Blue Cross (12% and 12%), and other payors, (58% and 63%), respectively.

OmniCare Health Plan (OmniCare) is a local managed care organization, which principally insures individuals covered by Medicaid. On July 31, 2001 the Commissioner for the Office of Financial and Insurance Services of the State of Michigan (OFIS) placed OmniCare Health Plan into "rehabilitation." OmniCare was determined to be insolvent by OFIS as a result of its negative net worth and working capital deficiency. Under the rehabilitation order, the Commissioner of OFIS assumed title to all assets, and is responsible for the ongoing operations of OmniCare.

At the time OmniCare was placed into rehabilitation, The DMC had approximately $55 million of net accounts receivable which related to the pre-rehabilitation period. Based on the insolvency of OmniCare at the rehabilitation date, The DMC recorded a charge to fiscal 2001 operations to reserve the amount outstanding during the year ended December 31, 2001. In July, 2002 The DMC entered into an agreement to settle all outstanding amounts due from OminCare for $9,540,000 and received payment of $5,200,000 during 2002. The remaining amount is due in equal installments on September 1, 2003 and 2004. Management adjusted the recorded allowance in 2002 to recognize the settlement and reflected such recovery in the statement of operations. Management believes adequate provision has been made in the financial statements for any additional adjustments, which may result from OmniCare's inability to pay amounts due The DMC.

3. Net Patient Service Revenue and Accounts Receivable (continued)

In December 2001, The DMC entered into a settlement agreement with another managed care payor to settle all outstanding claims prior to December 31, 2001 for $9,250,000 in installments through 2002. Based on recorded amounts, in fiscal 2001 The DMC recognized a loss of $7,562,000 under the terms of the settlement.

4. Investments

The DMC records investments in equity securities and debt securities at fair value using quoted market prices. Investments are summarized as follows:

	December 31, 2002			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(In Thousands)			
Cash and cash equivalents	$ 80,534	$ 1,052	$ (924)	$ 80,662
United States Government obligations	138,554	6,772	(6,743)	138,583
Corporate bonds	53,780	2,984	(2,302)	54,462
Common stocks	163,075	1,963	(21,065)	143,973
Foreign bonds	7,119	862	(26)	7,955
Other investments	8,813	644	(250)	9,207
	$ 451,875	$ 14,277	$ (31,310)	$ 434,842

	December 31, 2001			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(In Thousands)			
Cash and cash equivalents	$ 102,473	$ 345	$ (829)	$ 101,989
United States Government obligations	142,119	4,375	(4,174)	142,320
Corporate bonds	77,310	1,967	(2,784)	76,493
Common stocks	199,717	7,557	(18,033)	189,241
Foreign bonds	12,691	33	(416)	12,308
Other investments	16,046	628	(284)	16,390
	$ 550,356	$ 14,905	$ (26,520)	$ 538,741

4. Investments (continued)

Investment return is summarized as follows:

	Years ended December 31 2002	2001
	(In Thousands)	
Interest and dividends	$ 21,160	$ 31,106
Net realized losses	(25,948)	(10,362)
Other than temporary loss on investments	(10,255)	-
Change in net unrealized loss	(4,180)	(15,100)
Total investment (loss) income return	$ (19,223)	$ 5,644
Included in other revenue	$ 5,078	$ 15,525
Included in other income	(8,493)	4,838
Reported separately as change in unrealized loss	(6,148)	(12,108)
	(9,563)	8,255
Included in temporarily restricted interest (loss) income	(5,071)	381
Included in temporarily restricted unrealized loss	(4,589)	(2,992)
Total investment (loss) income return	$ (19,223)	$ 5,644

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

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.

Marketable securities: 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	
	2002	**2001**
	(In Thousands)	
Cash and cash equivalents	**$ 5,569**	$ 34,886
Current portion of assets whose use is limited	**5,645**	5,712
Assets whose use is limited or restricted, less current portion	**423,628**	504,591

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

	December 31	
	2002	**2001**
	(In Thousands)	
Carrying amount	**$ 583,398**	$ 583,224
Fair value	**593,237**	576,879

6. Credit Agreement

The DMC has a revolving credit agreement with GE Capital to provide financing to the DMC of up to $60,000,000. Borrowings under the credit agreement are based upon eligible accounts receivable which secure the amount outstanding. Eligible accounts receivable, as defined in the credit agreement, represent net accounts receivable which are less than 120 days old reduced by advances and allowances for doubtful accounts. The aggregate of eligible accounts receivable is also reduced by a $20,000,000 availability reserve. Eligible accounts receivable at May 31, 2003 was approximately $80 million which would allow for borrowings of approximately $60 million. Interest on borrowings is based on the current Libor rate plus 2.75% (4.19% at December 31, 2002). At December 31, 2002 and 2001, the DMC had no outstanding balance under the credit agreement, however the credit agreement was utilized at various amounts during the years ended December 31, 2002 and 2001. Under the terms of the credit agreement, the DMC is required to meet certain reporting requirements and quarterly covenants including minimum net worth, minimum fixed charge coverage ratio, accounts receivable days outstanding, debt to capitalization, and cash flow ratios. At December 31, 2002, the DMC was not in compliance with the minimum net worth, debt to capitalization, and minimum fixed charge coverage ratio covenants. The DMC obtained waivers from GE Capital as of December 31, 2002.

At March 31, 2003, the DMC had $45,279,000 outstanding under the credit agreement and was not in compliance with the minimum fixed charge coverage ratio covenant. On April 2, 2003 the DMC and GE Capital amended the agreement to extend the term through January 1, 2004 and eliminate covenants related to minimum net worth and debt to capitalization ratio. The DMC has obtained a waiver from GE Capital as of March 31, 2003.

On June 23, 2003 The DMC and GE Capital amended the credit agreement to waive the filing of audited financial statements until June 30, 2003, and to require weekly reporting of the borrowing base and accounts payable days outstanding, as defined. In addition, the credit agreement was amended to waive The DMC's required compliance with the fixed charge coverage ratio through the quarter ended December 31, 2003. With the amendments to the credit agreement, management expects to have full availability of the funds allowed under the credit agreement through January 1, 2004 (see Note 16).

7. Long-Term Debt and Leases

Long-term debt consists of the following:

	December 31 2002	2001
	(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	108,820	109,320
Series 1993B, interest at 4.80% to 5.75%, due 2023	128,185	131,445
Series 1995, interest at 5.75% to 6.7%, due 2026	41,420	42,615
Series 1997A, interest at 5.0% to 5.5%, due 2027	172,840	174,460
Series 1998A, interest at 5.0% to 5.25% due 2028	108,650	108,650
Obligations under capital leases	7,754	8,305
Notes payable and other obligations	20,908	14,159
	591,152	591,529
Less current portion	10,876	9,196
	$ 580,276	$ 582,333

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. The Master Indenture provides that each hospital member 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 $7,950,000 in 2003 to $37,585,000 in 2028.

7. Long-Term Debt and Leases (continued)

Loan agreements for the Series 1988, 1993, 1997 and 1998 bonds require a debt coverage ratio of 120% of maximum principal and interest which has been met in 2002 The DMC. Among other requirements of the Series 1995 loan agreement, which debt was assumed from an acquisition, 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. Based on the results of operations for the year ended December 31, 2002, the DMC is required to engage a consultant no later than six months following December 31, 2002. On May 19, 2003 the DMC entered into a Forbearance Agreement with MSHFA. Under the terms of the Forbearance Agreement, MSHFA will refrain from requiring the DMC to hire a consultant if days cash on hand and the debt service coverage ratio exceed certain required amounts at October 31, 2003 and December 31, 2003. If the DMC is unable to meet the requirements of the Forbearance Agreement, the DMC will be required to retain a consultant within 30 days of disclosure of the information to MSHFA.

Portions of the proceeds of the Series 1988A, 1988B, 1991A, 1993A, 1993B and 1995 Bonds, as well as the Series 1997A Bonds, were designated to advance refund previously issued hospital revenue bonds. The principal outstanding under all of these previous issues, amounting to $30,780,000 at December 31, 2002, is considered to be extinguished for financial reporting purposes and will be paid from escrow funds.

Interest paid was $32,838,000 in 2002 and $35,573,000 in 2001. In addition, the DMC capitalized interest of $1,435,000 in 2002.

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)	
2003	$ 10,574	$ 1,371
2004	11,242	1,378
2005	12,842	1,383
2006	14,625	1,389
2007	14,076	1,395
Thereafter	520,039	4,081
	$ 583,398	10,997
Less amounts representing interest		3,243
		$ 7,754

Expenses incurred under operating leases were $16,834,000 in 2002 and $13,480,000 in 2001.

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. In addition, The DMC has acquired excess professional liability and general liability coverage from a captive insurance company of which it holds a minority interest.

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 6.0% in 2002 and 6.5% in 2001. Professional liability expense was $41,547,000 in 2002 and $22,969,000 in 2001.

8. Professional and General Liability Claims (continued)

Periodically, The DMC reviews its history of professional liability losses and reserves for known claims. In 2001, management determined in consultation with its actuary that it is appropriate to change the loss limit in determining the estimated liability for incurred-but-not-reported claims. This change in estimate had the effect of reducing insurance expense by approximately $5,000,000 in 2001.

During 2001, the Detroit Medical Center sold its interest in the common stock of the Michigan Hospital Association Insurance Company resulting in a gain of $6,731,000, which is included in other operating income.

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 and participates in various defined contribution plans. The benefits under the defined benefit plan are based in general on years of service and final average earnings. The DMC's funding policy 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.

9. Retirement Benefits (continued)

The following table provides a reconciliation of the changes in the plan's benefit obligation and fair value of assets for the years ended December 31, 2002 and 2001, and a statement of the funded status as of December 31, 2002 and 2001.

	Years ended December 31	
	2002	**2001**
	(In Thousands)	
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of year	**$ 721,834**	$ 638,318
Service cost	**22,403**	22,857
Interest cost	**51,384**	47,387
Plan amendments	**(3,597)**	-
Actuarial loss	**62,359**	34,200
Benefits paid	**(22,142)**	(20,928)
Benefit obligation at end of year	**832,241**	721,834
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	**567,315**	612,019
Actual loss on plan assets	**(62,675)**	(23,776)
Benefits paid	**(22,142)**	(20,928)
Fair value of plan assets at end of year	**482,498**	567,315
Funded status at December 31	**(349,743)**	(154,519)
Unrecognized net actuarial loss	**278,005**	104,046
Unrecognized prior service credit	**(3,309)**	-
Additional minimum retirement liability	**(174,686)**	-
Accrued benefit cost	**$(249,733)**	$ (50,473)

9. Retirement Benefits (continued)

Amounts recognized in the statement of financial position consists of:

	December 31	
	2002	2001
	(In Thousands)	
Current portion of accrued benefit cost	$ (33,747)	$ -
Accrued benefit cost	(215,986)	(50,473)
Net accrued benefit cost	$ (249,733)	$ (50,473)

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

	Years ended December 31	
	2002	2001
	(In Thousands)	
Service cost-benefits earned during the period	$ 22,403	$ 22,857
Interest cost on projected benefit obligation	51,384	47,387
Expected return on assets	(51,543)	(55,758)
Amortization of prior service (credit) cost	(287)	61
Recognition of actuarial loss	2,618	-
Net retirement expense of defined benefit plan	24,575	14,547
Other retirement plan expense	434	434
Net retirement expense	$ 25,009	$ 14,981

9. Retirement Benefits (continued)

The assumptions used in the accounting for the Plan are set forth below:

	December 31	
	2002	**2001**
Discount rate	6.75%	7.25%
Expected long-term rate of return on assets	9.25%	9.25%
Rate of increase in compensation levels	4.50%	4.50%

The change in the projected benefit obligation in 2002 and 2001 was principally due to the decrease in the discount rate.

The investments of the Plan are held in trust by a trustee and managed in accordance with guidelines established by The DMC. Investments include U. S. Government securities, bank common trust funds, corporate equity and debt securities, and cash equivalents.

In April 2003 The DMC announced that benefits provided under the consolidated pension plan would be frozen effective June 1, 2003. Management has elected to freeze the pension benefits to reduce the expected increase in pension expense for 2003. The DMC has not determined when or at what level employees will resume earning pension benefits.

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

	Years ended December 31	
	2002	**2001**
	(In Thousands)	
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of year	$ 19,911	$ 18,883
Service cost	5	8
Interest cost	1,705	1,425
Participant contributions	685	478
Actuarial loss	5,895	1,497
Benefits paid	(3,075)	(2,380)
Benefit obligation at end of year	25,126	19,911
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	2,676	2,504
Actual return on plan assets	156	243
Benefits paid from plan assets	(38)	(71)
Fair value of plan assets at end of year	2,794	2,676
Funded status at December 31	(22,332)	(17,235)
Unrecognized net actuarial loss	510	573
Unrecognized prior service cost	7,952	2,433
Accrued benefit cost	$ (13,870)	$ (14,229)

10. Other Postretirement Employee Benefits (continued)

Net periodic postretirement benefit cost includes the following components:

	Years ended December 31 2002	2001
	(In Thousands)	
Service cost	$ 5	$ 8
Interest cost	1,705	1,425
Expected return on assets	(160)	(154)
Amortization of prior service cost	63	-
Amortization of unrecognized net loss	380	63
Net periodic postretirement benefit cost	$ 1,993	$ 1,342

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 5.24% for 2002 and is assumed to decrease to 5.00% in 2003 and remain at that level thereafter. The discount rate was 6.75% at December 31, 2002 and 7.25% at December 31, 2001.

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:

	1-Percentage Point Increase	1-Percentage Point Decrease
	(In Thousands)	
Effect on total of service and interest cost components	$ 102	$ (112)
Effect on postretirement benefit obligation	1,631	(1,756)

11. Commitments and Contingencies

On January 1, 2002 The DMC entered into an amended information systems outsourcing arrangement with Caretech Corporation. Under the agreement The DMC outsourced its entire information system operations for a 10 year period with contractually specified minimums over the period of the contract. The contractual commitments, excluding extensions, capital requirements and service level adjustments, at December 31, 2002 aggregate approximately $576,000,000 through December, 2011.

In December 2001 The DMC entered into an agreement with Provider HealthNet Services, Inc. (PHNS) to outsource the medical records and transcription services of The DMC for a period of 10 years beginning in January 2002. The medical records outsourcing is represented by a 10-year contractual commitment with contractually specified minimums over the term of the agreement. The contractual minimums aggregate $339,754,000 over the remaining term of the agreement to include medical record and transcription services, and the development of an electronic medical record. The DMC has the ability to terminate the agreement after December 31, 2006, subject to payment of certain penalty amounts. In connection with this outsourcing agreement, The DMC sold its medical records assets to PHNS and received a cash advance of $13,326,000 and equity position ($2,081,000 at December 31, 2002) in PHNS. The DMC is currently in litigation with PHNS to rescind the contract. Management believes that no adjustments in excess of amounts recorded as deferred obligation and equity will be necessary for any settlement that may occur.

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, 2002, The DMC had commitments of $52,300,000 for the purchase of property and equipment in fiscal 2003.

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 restructuring and impairment costs and changes in estimate, classified by function are as follows:

	Years ended December 31	
	2002	**2001**
	(In Thousands)	
Health care services	**$ 1,413,606**	$ 1,337,271
Teaching	**128,295**	123,604
General and administrative	**178,933**	173,477
	$ 1,720,834	$ 1,634,352

13. Related Party Transactions

The DMC purchases clinical professional services from Wayne State University. Purchases for these services amounted to $60,221,000 and $59,652,000 for the year ended December 31, 2002 and 2001, 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.

14. Physician Practice Impairment Charges

During 2002, The DMC announced plans to privatize the physicians in its primary care network. Under the privatization plan, certain physician employment arrangements are being terminated effective March 31, 2003, and those physicians will enter 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 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 an "asset to be held and used" 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 $4,998,000 to reduce the carrying value of the assets to fair value. Management has recorded their best estimate of costs to be incurred under the privatization plan, however additional costs may be incurred in 2003.

15. Acquisition of Madison Community Hospital

On July 31, 2002, The DMC acquired the assets of Madison Community Hospital, located in Madison Heights, Michigan, for total consideration of $12,000,000. The consideration included a cash payment of $3,000,000, a land contract for $5,800,000, and a promissory note for $3,200,000. The purchase price associated with the acquisition exceed the fair value of the net assets acquired as follows:

Purchase price	**$ 12,000,000**
Fair value of tangible net assets	**(6,875,000)**
Excess of purchase price over tangible net assets	**$ 5,125,000**

16. Operating Results, Performance Improvement and Liquidity Matters

For the years ended December 31, 2002 and 2001, The DMC has incurred losses of $102,151,000 and $65,914,000, respectively. The continued deterioration in financial results and position has resulted from declining payments for services rendered, declining admissions, continued provision of services to the uninsured, insolvency of a managed care payor, and inability to obtain additional financial support from City, County, State, and Federal sources. The DMC also had a working capital deficiency of $135,089,000 and $57,986,000 at December 31, 2002 and 2001, respectively. In addition, The DMC has not met certain of the financial requirements related to a credit agreement (see Note 6) and a loan agreement (see Note 7).

On May 20, 2003 the Board of Trustees approved a consolidation plan that includes the partial closure of Detroit Receiving Hospital and University Health Center (DRHUHC). Under the plan, certain inpatient services of DRHUHC will be transferred to Harper-Hutzel Hospital, with DRHUHC continuing to operate its trauma center and other essential services. Services will also be transferred from Hutzel Women's Hospital to Sinai-Grace Hospital. The DMC has retained an outside consultant to assist with the development and implementation of the consolidation plan, as well as other operational improvement initiatives to reduce operating costs. In connection with the consolidation plan The DMC has announced its plan to reduce its workforce. Management is in the process of identifying the positions that will be eliminated and the related costs.

As discussed in Note 6, The DMC has obtained waivers as of December 31, 2002 and March 31, 2003 related to certain financial covenant requirements contained in the credit agreement which were not met. The DMC amended the credit agreement on April 2, 2003 and June 23, 2003 to extend the credit agreement through January 1, 2004 and eliminate all financial covenant requirements which The DMC has a remote probability of meeting from the agreement. As a result of these changes, management expects to have full availability of amounts available under the credit agreement through January 1, 2004. As discussed in Note 7, The DMC entered into a Forbearance Agreement with MSHFA related to not meeting the financial requirements under a loan agreement. Under the terms of the Forbearance Agreement, MSHFA will refrain from requiring The DMC to hire a consultant if days cash on hand and the debt service coverage ratio exceed certain required amounts at October 31, 2003 and December 31, 2003. If The DMC is unable to meet the requirements of the Forbearance Agreement, the DMC will be required to retain a consultant within 30 days of disclosure of the information to MSHFA.

16. Operating Results, Performance Improvement and Liquidity Matters (continued)

Management continues to pursue additional funding from government sources, including the City of Detroit, Wayne County, the State of Michigan and the Federal Government. However, no assurance can be provided that The DMC will be successful in obtaining funding from these sources, or the duration of such funding.

While there is no assurance that the consolidation plan will result in financial improvements for fiscal 2003 being achieved, based on current estimates of operating results, The DMC management believes that cash flow from operations, funds available from credit agreements, and funds previously designated for capital improvements and board designated funds will be sufficient to finance both ongoing operations and required capital commitments for fiscal 2003.

Consolidating Financial Information