Consolidated Financial Statements and Consolidating Financial Information

The Detroit Medical Center and Subsidiaries

Years ended December 31, 2001 and 2000 with Report of Independent Auditors

0111-0245456

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Contents

0111-0245456

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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, 2001 and 2000, and the related consolidated statements of operations, 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, 2001 and 2000, 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

February 22, 2002

The Detroit Medical Center and Subsidiaries

Consolidated Balance Sheets

	December 31 2001	December 31 2000
	(in thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 34,886	$ 47,753
Net patient accounts receivable *(Note 3)*	124,358	151,253
Estimated third-party payor settlements *(Note 3)*	59,455	41,353
Other accounts receivable	43,302	34,996
Current portion of assets whose use is limited or restricted	5,712	7,405
Supplies	14,734	14,679
Prepaid expenses and other	24,035	20,796
Total current assets	306,482	318,235
Assets whose use is limited or restricted, less current portion *(Note 4)*:		
Board designated funds for capital improvements	168,114	185,530
Board designated funds for specific purposes	48,959	68,065
Professional liability funds	114,254	119,255
Funds held in trust under bond agreements *(Note 7)*	53,026	53,687
Endowment funds	54,167	54,418
Pledges receivable	28,044	21,552
Donor restricted funds	66,071	68,366
	532,635	570,873
Property and equipment, net *(Note 2)*	640,811	660,516
Other noncurrent assets *(Note 2)*	53,356	55,052
Total assets	$ 1,533,284	$ 1,604,676

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	December 31 2001	December 31 2000
	(in thousands)	
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	$ 180,332	$ 155,119
Accrued compensation and related amounts	41,865	44,768
Estimated third-party payor settlements *(Note 3)*	80,847	71,101
Advance payment from third-party payor	35,296	57,632
Current portion of long-term debt *(Note 7)*	9,196	7,404
Current portion of accrued professional liability losses	16,932	16,795
Total current liabilities	364,468	352,819
Long-term debt, less current portion *(Note 7)*	582,333	576,915
Other noncurrent liabilities, less current portion *(Notes 2, 8, 9 and 10)*	230,557	248,367
	812,890	825,282
Net assets:		
Unrestricted	207,641	270,207
Temporarily restricted	86,307	101,950
Permanently restricted	61,978	54,418
	355,926	426,575
Total liabilities and net assets	$ 1,533,284	$ 1,604,676

See accompanying notes.

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The Detroit Medical Center and Subsidiaries

Consolidated Statements of Operations

	Year ended December 31	
	2001	2000
	(in thousands)	
Unrestricted revenue and other support:		
Net patient service revenue *(Note 3)*	$ 1,532,568	$ 1,492,560
Other revenue	77,552	74,960
Net assets released from restrictions for operations	18,296	15,544
Total revenue and other support	1,628,416	1,583,064
Expenses:		
Salaries, wages and benefits	653,525	644,786
Services, supplies and other *(Note 13)*	644,081	607,068
Provision for uncollectible accounts	181,276	213,026
Professional liability insurance *(Note 8)*	23,096	18,204
Interest	36,096	35,304
Depreciation and amortization	96,278	98,577
	1,634,352	1,616,965
Loss from operations before write-off due to insolvency of managed care payor, settlement with managed care payor, and change in estimate	(5,936)	(33,901)
Write-off due to insolvency of managed care payor *(Note 3)*	(55,306)	-
Settlement with managed care payor *(Note 3)*	(7,562)	-
Change in estimate *(Note 14)*	-	12,079
Loss from operations	(68,804)	(21,822)
Other income (expense):		
Investment income	4,309	19,062
Closed facility expense	(5,314)	(5,246)
Gain on sale of assets	3,895	-
Excess of expenses over revenue	(65,914)	(8,006)
Other changes in unrestricted net assets:		
Change in unrealized loss in fair value of investments	(12,108)	(7,008)
Net assets released from restrictions for long-lived assets	20,440	7,362
Other changes	(4,984)	(295)
Decrease in unrestricted net assets	$ (62,566)	$ (7,947)

See accompanying notes.

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The Detroit Medical Center and Subsidiaries

Consolidated Statements of Changes in Net Assets

	Year ended December 31 2001	2000
	(in thousands)	
Decrease in unrestricted net assets	$ (62,566)	$ (7,947)
Temporarily restricted net assets:		
Contributions	29,188	24,997
Investment income	381	6,265
Change in unrealized loss in fair value of investments	(2,992)	(4,566)
Net assets released from restrictions for long-lived assets	(20,440)	(7,362)
Net assets released from restrictions for operations	(18,296)	(15,544)
Other changes	(3,484)	295
(Decrease) increase in temporarily restricted net assets	(15,643)	4,085
Permanently restricted net assets:		
Contributions	5,152	7,590
Other changes	2,408	(3,294)
Increase in permanently restricted net assets	7,560	4,296
(Decrease) increase in net assets	(70,649)	434
Net assets at beginning of year	426,575	426,141
Net assets at end of year	$ 355,926	$ 426,575

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Year ended December 31 2001	2000
	(In thousands)	
Operating activities		
(Decrease) increase in net assets	$ (70,649)	$ 434
Adjustments to reconcile decrease in net assets to cash provided by operating activities:		
Depreciation and amortization	96,278	98,577
Gain on sale of assets	(3,895)	-
Change in estimate *(Note 15)*	-	(12,079)
Change in net unrealized gains in fair value of investments	15,100	11,574
	36,834	98,506
Changes in operating assets and liabilities:		
Patient accounts receivable and third-party payor settlements	9,069	(26,649)
Other current assets	(11,500)	(8,488)
Accounts payable and accrued expenses	25,213	(35,390)
Other current liabilities	(2,903)	(1,426)
Due to third-party payors	9,746	12,013
Advance from third-party payor	(22,336)	(11,246)
Accrued pension costs	14,547	12,116
Accrued unfunded professional liability losses	(18,082)	(27,209)
Other operating activities	(8,530)	(5,155)
Cash provided by operating activities	32,058	7,072
Investing activities		
Purchase of property and equipment	(77,507)	(83,126)
Decrease in assets whose use is limited or restricted, excluding professional liability funds	19,039	116,249
Proceeds from sale of assets	4,046	-
Other investing activities	2,287	641
Cash (used in) provided by investing activities	(52,135)	33,764
Financing activities		
Proceeds from long-term borrowings	14,655	-
Repayment of long-term debt	(7,445)	(35,180)
Cash provided by (used in) financing activities	7,210	(35,180)
(Decrease) increase in cash and cash equivalents	(12,867)	5,656
Cash and cash equivalents at beginning of year	47,753	42,097
Cash and cash equivalents at end of year	$ 34,886	$ 47,753

See accompanying notes.

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1. Organization and Significant Accounting Policies

Organization

The Detroit Medical Center 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 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 DMC. Such corporations are referred to herein as the subsidiaries of The DMC. The consolidated financial statements include the accounts of The DMC 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.

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 revenue over expense. Unrealized gains and losses determined to be temporary are recorded as an addition to or deduction from net assets.

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 commercial insurance carriers, certain 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.

1. Organization and Significant Accounting Policies (continued)

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

Revenue from the Medicare and Medicaid programs accounted for approximately 25% and 22%, respectively, of net patient service revenues for 2001. 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. At this time, no specific alleged violations, claims, or assessments have been made. Management intends to fully cooperate with the governmental agencies in its request for information.

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)*.

1. Organization and Significant Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific purpose, such as capital additions or research. When a donor restriction is satisfied, such as through expenditure for the restricted purpose, temporarily restricted net assets are reclassified as net assets released from restrictions for 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.

Excess (Deficiency) of Revenue Over Expenses

The statements of operations and changes in net assets include 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, 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

Management periodically reviews the carrying value of its long-lived tangible and intangible assets to determine if an impairment has occurred or whether changes in circumstances have occurred that would require a revision to the remaining useful life. In making such determination, management evaluates the performance, on an undiscounted basis, of the underlying operations or assets, which give rise to such amount.

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 DMC, 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.

Reclassification

Certain 2000 amounts have been reclassified to conform with the 2001 presentation.

2. Additional Balance Sheet Information

	December 31	
	2001	2000
	(in thousands)	
Property and equipment:		
Land and land improvements	$ 13,198	$ 12,678
Buildings and improvements	935,567	901,868
Equipment	684,291	678,271
Construction in progress	51,468	32,000
	1,684,524	1,624,817
Accumulated depreciation	(1,043,713)	(964,301)
	$ 640,811	$ 660,516
Other noncurrent assets:		
Goodwill and other intangible assets	$ 7,000	$ 7,000
Accumulated amortization	(3,029)	(2,453)
	3,971	4,547
Deferred debt issuance costs	15,411	16,264
Deferred compensation investments	11,489	15,062
Other	22,485	19,179
	$ 53,356	$ 55,052

2. Additional Balance Sheet Information (continued)

	December 31 2001	December 31 2000
	(in thousands)	
Other noncurrent liabilities, less current portion:		
Accrued professional liability losses	$ 146,856	$ 170,867
Accrued pension costs	50,473	35,926
Other postretirement liability	14,229	14,718
Other	18,999	26,856
	$ 230,557	$ 248,367

3. Net Patient Accounts Receivable

	December 31 2001	December 31 2000
	(in thousands)	
Net patient accounts receivable:		
Gross patient accounts receivable	$ 565,679	$ 733,859
Allowances and advances under contractual arrangements	(364,274)	(470,514)
Allowance for uncollectible accounts	(77,047)	(112,092)
	$ 124,358	$ 151,253

During the year ended December 31, 2001 and 2000, The DMC recognized an increase of $35,207,000 and $7,218,000, respectively, in net patient service revenue due to favorable settlements with third-party payors.

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.

3. Net Patient Accounts Receivable (continued)

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 operations to reserve the amount outstanding. Management believes that adequate provision has been made in the financial statements for any adjustments, which may result from the OmniCare's inability to pay amounts due the DMC.

In December 2001, the DMC entered into a settlement agreement with a 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, the DMC recognized a loss of $7,562,000 under the terms of the settlement.

Net patient service revenue is shown net of contractual and charity care adjustments of $1,356,887 in 2001 and $1,284,076 in 2000.

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, 2001 and 2000 include net amounts due from Medicare (11% and 11%), Medicaid (14% and 12%), Blue Cross (12% and 11%), and other payors, (63% and 66%), respectively.

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, 2001			
	Amortized Cost	Gross Unrealized Gains	Gross 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)

	December 31, 2000			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash and cash equivalents	$128,602	$ 1,196	$ (1,415)	$128,383
United States Government obligations	166,833	4,342	(2,647)	168,528
Corporate bonds	79,006	1,007	(5,339)	74,674
Common stocks	193,512	17,646	(15,748)	195,410
Foreign bonds	20,159	1,420	(888)	20,691
Other investments	8,882	578	(332)	9,128
	$596,994	$26,189	$(26,369)	$596,814

Investment return is summarized as follows:

	Year ended December 31	
	2001	2000
	(in thousands)	
Interest and dividends	$ 31,106	$ 36,989
Net realized (losses) gains	(10,362)	10,805
Change in net unrealized loss	(15,100)	(11,574)
Total investment return	$ 5,644	$ 36,220
Included in other revenue	$ 15,525	$ 25,208
Included in other income	4,838	16,321
Reported separately as change in unrealized loss	(12,108)	(7,008)
	8,255	34,521
Included in temporarily restricted interest income	381	6,265
Included in temporarily restricted unrealized loss	(2,992)	(4,566)
Total investment return	$ 5,644	$ 36,220

4. Investments (continued)

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 gains 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	
	2001	**2000**
	(in thousands)	
Cash and cash equivalents	$ 34,886	$ 47,753
Current portion of assets whose use is limited	5,712	7,405
Assets whose use is limited or restricted, less current portion	532,635	570,873

5. Fair Value of Financial Instruments (continued)

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

	December 31	
	2001	2000
	(in thousands)	
Carrying amount	$ 583,224	$ 574,350
Fair value	576,879	512,312

6. Line of Credit

The DMC has a financing agreement with GE Capital to provide a $60,000,000 secured line of credit. The credit line, which expires October 13, 2003, is secured by eligible accounts receivable of The DMC. Interest on any borrowings will be determined at the date of the borrowing based on Libor plus 2.75% (4.87% at December 31, 2001). Under the terms of the line, 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 capital and cash flow ratios. At December 31, 2001, the DMC was not in compliance with the minimum net worth and minimum fixed charge coverage ratio covenants. The DMC has obtained waivers from GE Capital as of December 31, 2001 and has amended the agreements for future periods. At December 31, 2001 and 2000, the DMC had no outstanding balance under the line of credit.

7. Long-Term Debt and Leases

Long-term debt consists of the following:

	December 31 2001	December 31 2000
	(in thousands)	
Michigan State Hospital Finance Authority (MSHFA) bonds:		
Series 1988A and 1988B, interest at 8.125%, due 2010	$ 2,575	$ 2,575
Series 1991A, interest at 7.1%, due 2001		2,280
Series 1993A, interest at 5.85% to 6.5%, due 2018	109,320	109,795
Series 1993B, interest at 4.80% to 5.75%, due 2023	131,445	132,285
Series 1995, interest at 5.75% to 6.7%, due 2026	42,615	43,745
Series 1997A, interest at 5.0% to 5.5%, due 2027	174,460	174,460
Series 1998A, interest at 5.0% to 5.25% due 2028	108,650	108,650
Obligations under capital leases	8,305	9,969
Notes payable and other obligations	14,159	560
	591,529	584,319
Less current portion	9,196	7,404
	$ 582,333	$ 576,915

The DMC 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 DMC 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 $6,575,000 in 2002 to $37,585,000 in 2028.

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 $78,405,000 at December 31, 2001, is considered to be extinguished for financial reporting purposes and will be paid from escrow funds.

7. Long-Term Debt and Leases (continued)

During March 2000 The DMC completed a tender offer for $27,560,000 of the Series 1995 bonds. The bonds were redeemed through the use of $25,629,000 in unspent bond proceeds from the initial offering, and resulted in a gain of $962,000 which is included in other income on the statement of operations. In addition, during 2000 The DMC obtained approval from the Internal Revenue Service to utilize approximately $15 million of unspent bond proceeds for capital projects other than their initial intended use.

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)	
2002	$ 8,592	$ 1,366
2003	10,321	1,371
2004	10,975	1,378
2005	11,540	1,383
2006	14,265	1,389
Thereafter	527,531	5,478
	$583,224	12,365
Less amounts representing interest		4,060
		$ 8,305

Interest paid was $35,573,000 in 2001 and $34,632,000 in 2000. Expenses incurred under operating leases were $13,480,000 in 2001 and $17,212,000 in 2000.

8. Professional and General Liability Losses

The DMC has established an offshore captive insurance company to provide professional and general liability coverage to The DMC's hospital subsidiaries, certain medical staff members and other affiliates. Those subsidiaries not participating in the captive insurance programs continue to provide their own coverages. 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.

8. Professional and General Liability Losses (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 6.5% in 2001 and 2000. Professional liability expense was $22,969,000 in 2001 and $18,204,000 in 2000.

Periodically, The DMC reviews its history of professional liability losses and reserves for known claims. Management has 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 and $15,000,000 in 2000.

During 2001, the DMC 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. Pension Benefits

The DMC has a noncontributory defined benefit retirement plan covering substantially all of the employees of The DMC and its affiliates 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. Pension 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, 2001 and 2000, and a statement of the funded status as of December 31, 2001 and 2000.

	Year ended December 31	
	2001	2000
	(in thousands)	
Reconciliation of benefit obligation		
Benefit obligation at the beginning of year	$ 638,318	$ 566,681
Service cost	22,857	23,499
Interest cost	47,387	44,633
Actuarial loss	34,200	22,898
Benefits paid	(20,928)	(19,393)
Benefit obligation at end of year	721,834	638,318
Reconciliation of fair value of plan assets		
Fair value of plan assets at beginning of year	612,019	617,961
Actual (loss) return on plan assets	(23,776)	13,451
Benefits paid	(20,928)	(19,393)
Fair value of plan assets at end of year	567,315	612,019
Funded status at December 31	(154,519)	(26,299)
Unrecognized net actuarial loss (gain)	104,046	(9,688)
Unrecognized prior service cost	-	61
Accrued benefit cost	$ (50,473)	$ (35,926)

9. Pension Benefits (continued)

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

	Year ended December 31	
	2001	2000
	(in thousands)	
Service cost-benefits earned during the period	$ 22,857	$ 23,499
Interest cost on projected benefit obligation	47,387	44,633
Expected return on assets	(55,758)	(54,836)
Amortization of prior service cost	61	167
Recognition of actuarial gain	-	(1,032)
Net pension expense of defined benefit plan	14,547	12,431
Other pension plan expense	434	1,019
Net pension expense	$ 14,981	$ 13,450

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

	December 31	
	2001	2000
Discount rate	7.25%	7.75%
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 2001 and 2000 was principally due to the change in the discount rate, which decreased .50% in 2001 and .25% in 2000.

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.

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 provide 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:

	Year ended December 31	
	2001	2000
	(in thousands)	
Reconciliation of benefit obligation		
Benefit obligation at the beginning of year	$ 18,883	$ 20,407
Service cost	8	8
Interest cost	1,425	1,446
Participant contributions	478	445
Actuarial loss (gain)	1,497	(1,025)
Benefits paid	(2,380)	(2,398)
Benefit obligation at end of year	19,911	18,883
Reconciliation of fair value of plan assets		
Fair value of plan assets at beginning of year	2,504	2,424
Actual return on plan assets	243	174
Benefits paid	(71)	(94)
Fair value of plan assets at end of year	2,676	2,504
Funded status at December 31	(17,235)	(16,379)
Unrecognized net actuarial loss	573	636
Unrecognized prior service cost	2,433	1,025
Accrued benefit cost	$(14,229)	$(14,718)

10. Other Postretirement Employee Benefits (continued)

Net periodic postretirement benefit cost includes the following components:

	Year ended December 31 2001	2000
	(in thousands)	
Service cost	$ 8	$ 8
Interest cost	1,425	1,446
Expected return on assets	(154)	(150)
Amortization of prior service cost	63	63
Net periodic postretirement benefit cost	$ 1,342	$ 1,367

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 5.96% for 2001 and is assumed to decrease uniformly to 5.0% in 2003 and remain at that level thereafter. The discount rate was 7.25% at December 31, 2001 and 7.75% at December 31, 2000.

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	$ 88	$ (83)
Effect on postretirement benefit obligation	993	(1,536)

11. Commitments and Contingencies

In August 1999 The DMC has entered into an information systems outsourcing arrangement with Compuware Corporation (*see Note 13*). 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 contract provides for two two-year extensions at the option of the DMC. The contractual commitments, excluding extensions, at December 31, 2001 aggregate approximately $400 million through August, 2008.

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 $369,000,000 over the term of the agreement to include medical record and transcription services, and the development of a electronic medical record. The DMC has the ability to terminate the agreement after December 31, 2006, subject to the payment of certain penalty amounts. In connection with the outsourcing agreement, The DMC sold its medical records assets to PHNS and received a cash advance and equity position in PHNS.

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, 2001, The DMC had commitments of $41,365,000 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 restructuring and impairment costs and changes in estimate, classified by function are as follows:

	Year ended December 31 2001	2000
	(in thousands)	
Health care services	$ 1,337,271	$ 1,334,311
Teaching	123,604	110,278
General and administrative	173,477	172,376
	$ 1,634,352	$ 1,616,965

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13. Related Party Transactions

The DMC purchases services related to the operation of its information systems (*see Note 11*) from an entity in which one of The DMC trustees is an officer. The DMC purchased services and capital assets related to information systems, which amounted to $76,244,000 and $89,753,000, for the years ended December 31, 2001 and 2000, respectively. The DMC also purchases clinical professional services from Wayne State University. Purchases for these services amounted to $82,752,000 and $79,752,000 for the year ended December 31, 2001 and 2000, respectively.

The DMC has transactions with other affiliated entities 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. Change in Estimate

During 2000, The DMC determined that the Rehabilitation Institute of Michigan facility would not be sold as management had previously intended. The DMC previously recorded an impairment allowance as the building was considered an "asset held for sale" in accordance with the provisions of SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets to be Disposed Of". The DMC reversed $2,779,000 of the impairment allowance recorded in 1997.

The DMC's Hutzel and Sinai facilities had been considered impaired for accounting purposes and accruals had been recorded for unrecovered demolition costs. During 2000, management determined the accruals associated with the demolition of Hutzel Hospital and the former Sinai Hospital facilities would no longer be necessary due to changes in management's intended use for the facilities. The DMC has reversed accruals of $9,300,000 related to the demolition of these facilities.

15. Operating Results and Performance Improvement

For the years ended December 31, 2001 and 2000, The DMC has incurred decreases in unrestricted net assets of $62,566,000 and $7,947,000 respectively. The decreases have resulted from declining payments for services rendered, excess facility capacity, continued provision of services to the indigent, and the insolvency of a managed care payor. The DMC continues to develop and implement action plans to improve its operating performance.

DMC management's plan for fiscal 2002 includes improving operational performance through ongoing cost reductions, gaining market share through leveraging The DMC's patient care programs, more efficient utilization of facilities, improvement of the financial performance of its ambulatory facilities and physician practices, and continued evaluation of programs and functions which may not meet the core business objectives of The DMC. While there is no assurance that financial targets for fiscal 2002 will be achieved, based on current estimates, management believes that cash flow from operations, line of credit arrangements, and funds previously designated for capital improvements will be sufficient to finance both ongoing operations and required capital commitments for fiscal 2002.

In addition, The DMC continually contracts and seeks to renew contracts with payors at rates, which will improve margins. To the extent The DMC in unable to obtain such rates, and to achieve performance improvement, or as a result of legislative action there are payment reductions or increases in benefits without corresponding increases in payments, The DMC's financial position, results of operation and cash flows could be adversely impacted.