

**Consolidated Financial Statements and
Consolidating Financial Information**

The Detroit Medical Center and Subsidiaries

*Years ended December 31, 1999 and 1998
with Report of Independent Auditors*

 **ERNST & YOUNG LLP**



The Detroit Medical Center and Subsidiaries

Consolidated Financial Statements and Consolidating Financial Information

Years ended December 31, 1999 and 1998

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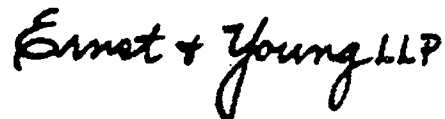
Report of Independent Auditors

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, 1999 and 1998, 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 generally accepted auditing standards. 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, 1999 and 1998, and the consolidated results of their operations, their changes in net assets and their cash flows for the years then ended in conformity with generally accepted accounting principles.



February 25, 2000, except for Note 6
as to which the date is April 4, 2000

The Detroit Medical Center and Subsidiaries

Consolidated Balance Sheets

	December 31	
	1999	1998
	<i>(in thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 42,097	\$ 30,787
Net patient accounts receivable <i>(Note 3)</i>	125,989	130,682
Estimated third-party payor settlements <i>(Note 1)</i>	39,968	30,879
Other accounts receivable	34,732	20,845
Current portion of assets whose use is limited or restricted	9,660	14,375
Supplies	14,263	10,593
Prepaid expenses and other	12,988	10,726
Total current assets	279,697	248,887
 Assets whose use is limited or restricted,		
less current portion <i>(Note 4)</i>:		
Board designated funds for capital improvements	281,009	289,181
Board designated funds for specific purposes	101,381	87,911
Professional liability funds	122,152	168,977
Funds held in trust under bond agreements <i>(Note 7)</i>	89,802	185,731
Endowment funds	50,122	43,438
Donor restricted funds	59,237	44,026
	703,703	819,264
 Property and equipment <i>(Notes 1, 2 and 4)</i>	 670,279	 638,608
 Other noncurrent assets <i>(Notes 2)</i>	 53,285	 55,009
Total assets	\$ 1,706,964	\$ 1,761,768

	December 31	
	1999	1998
	<i>(in thousands)</i>	
Liabilities and net assets		
Current liabilities:		
Revolving line of credit notes <i>(Note 6)</i>	\$ -	\$ 33,889
Accounts payable and accrued expenses	190,509	180,883
Accrued compensation and related amounts	46,194	55,113
Estimated third-party payor settlements <i>(Note 1)</i>	59,088	35,615
Advance payment from third-party payor	68,878	-
Current portion of long-term debt <i>(Note 7)</i>	4,990	9,555
Current portion of accrued professional liability losses	22,478	22,624
Total current liabilities	<u>392,137</u>	<u>337,679</u>
Long-term debt, less current portion <i>(Note 7)</i>	614,509	619,513
Other noncurrent liabilities, less current portion <i>(Notes 1, 2, 8, 9 and 10)</i>	274,177	252,532
Net assets:		
Unrestricted	278,154	428,421
Temporarily restricted	97,865	80,185
Permanently restricted	50,122	43,438
	<u>426,141</u>	<u>552,044</u>
Total liabilities and net assets	<u>\$ 1,706,964</u>	<u>\$ 1,761,768</u>

See accompanying notes.

The Detroit Medical Center and Subsidiaries
Consolidated Statements of Operations

	Year ended December 31	
	1999	1998
	<i>(in thousands)</i>	
Unrestricted revenue and other support:		
Net patient service revenue <i>(Note 3)</i>	\$ 1,452,521	\$ 1,575,679
Other revenue	119,476	97,397
Net assets released from restrictions for operations	13,175	15,164
Total revenue and other support	1,585,172	1,688,240
Expenses:		
Salaries, wages and benefits	695,028	843,335
Services, supplies and other	703,793	635,828
Provision for uncollectible accounts	205,304	177,581
Interest	36,729	28,604
Depreciation and amortization	84,586	81,028
	1,725,440	1,766,376
Loss from operations before impairment and restructuring costs	(140,268)	(78,136)
Restructuring costs <i>(Note 16)</i>	32,047	-
Provision for impairment loss <i>(Note 15)</i>	-	54,689
Loss from operations	(172,315)	(132,825)
Other income:		
Investment income and other	67,314	26,774
Gain on sale of assets <i>(Note 16)</i>	6,639	-
Excess of expenses over revenue	(98,362)	(106,051)
Other changes in unrestricted net assets:		
Change in unrealized gains in fair value of investments <i>(Note 4)</i>	(59,769)	(2,594)
Net assets released from restrictions for long-lived assets	5,114	4,924
Other changes	2,750	2,773
Decrease in unrestricted net assets	\$ (150,267)	\$ (100,948)

See accompanying notes.

The Detroit Medical Center and Subsidiaries
Consolidated Statements of Changes in Net Assets

	Year ended December 31	
	1999	1998
	<i>(in thousands)</i>	
Decrease in unrestricted net assets	\$ (150,267)	\$ (100,948)
Temporarily restricted net assets:		
Contributions	31,995	21,447
Investment income	7,882	5,645
Change in unrealized gains in fair value of investments	(890)	1,608
Net assets released from restrictions for long-lived assets	(5,114)	(4,924)
Net assets released from restrictions for operations	(13,175)	(15,164)
Other changes	(3,018)	(4,324)
Increase in temporarily restricted net assets	<u>17,680</u>	<u>4,288</u>
Permanently restricted net assets:		
Contributions and other changes	<u>6,684</u>	<u>11,914</u>
Increase in permanently restricted net assets	<u>6,684</u>	<u>11,914</u>
Decrease in net assets	<u>(125,903)</u>	<u>(84,746)</u>
Net assets at beginning of year	<u>552,044</u>	<u>636,790</u>
Net assets at end of year	<u><u>\$ 426,141</u></u>	<u><u>\$ 552,044</u></u>

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Year ended December 31	
	1999	1998
	<i>(in thousands)</i>	
Operating activities		
Decrease in net assets	\$ (125,903)	\$ (84,746)
Adjustments to reconcile decrease in net assets to cash provided by operating activities:		
Depreciation and amortization	84,586	81,028
Gain on sale of assets <i>(Note 16)</i>	(6,639)	-
Provision for impairment loss <i>(Note 15)</i>	-	54,689
Change in net unrealized gains in fair value of investments	60,659	986
	<u>12,703</u>	<u>51,957</u>
Changes in operating assets and liabilities:		
Patient accounts receivable and third-party payor settlements	(4,396)	(17,160)
Other current assets	(19,876)	10,072
Accounts payable and accrued expenses	8,220	23,544
Due to third-party payors	23,473	(16,035)
Advance from third-party payor	68,878	-
Other current liabilities	(8,919)	(275)
Accrued pension costs	19,894	16,718
Accrued unfunded professional liability losses	44,155	19,258
Other operating activities	(1,994)	12,887
Cash provided by operating activities	<u>142,138</u>	<u>100,966</u>
Investing activities		
Purchase of property and equipment	(117,356)	(161,811)
Decrease (increase) in assets whose use is limited or restricted, excluding professional liability funds	19,149	(48,379)
Other investing activities	10,837	545
Cash used in investing activities	<u>(87,370)</u>	<u>(209,645)</u>
Financing activities		
Proceeds from long-term borrowings	-	108,650
Repayment of long-term debt	(9,569)	(11,106)
Payment of debt issue costs	-	(3,416)
(Repayment) borrowing on revolving line of credit notes	(33,889)	33,889
Cash provided by (used in) financing activities	<u>(43,458)</u>	<u>128,017</u>
Increase in cash and cash equivalents	11,310	19,338
Cash and cash equivalents at beginning of year	30,787	11,449
Cash and cash equivalents at end of year	<u>\$ 42,097</u>	<u>\$ 30,787</u>

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 1999

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 and its hospital subsidiaries constitute the academic health center of Wayne State University, and work 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)
- DMC Clinic Plan
- 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, and DMC Care 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.

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.

Marketable Securities

Marketable securities, which comprise substantially all assets whose use is limited or restricted, are stated at fair value, which is determined on the basis of quoted market prices.

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.

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. Estimated settlements are recorded in the period related services are rendered and adjusted in future periods as final settlements are determined. During 1999 and 1998, The DMC recognized an increase of \$20,362,000 and \$51,700,000, respectively; in net patient service revenue due to favorable settlements with third-party payors. Management believes that adequate provision has been made in the consolidated financial statements for any adjustments that may result from final settlements.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

During fiscal 1999, The DMC received a cash advance from the Medicaid program related to medical education and indigent volume for the period ending September 30, 2000. The cash advance will be recognized as income ratably through the period ended September 30, 2000.

Revenue from the Medicare and Medicaid programs accounted for approximately 24% and 16%, respectively, of net patient service revenues for 1999. 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 years activity. 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 periods ranging from five to twenty-five years (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.

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 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 revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, net assets released from restrictions for the purchase of long-lived assets, and extraordinary loss on extinguishment of debt.

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. See Note 14 for further discussion of impairment charges.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 revenues 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)

2. Additional Balance Sheet Information

	December 31	
	1999	1998
	<i>(in thousands)</i>	
Property and equipment:		
Land and land improvements	\$ 12,634	\$ 15,843
Buildings and improvements	818,267	759,730
Equipment	616,339	479,235
Construction in progress	89,738	185,907
	<u>1,536,978</u>	<u>1,440,715</u>
Accumulated depreciation	<u>(866,699)</u>	<u>(802,107)</u>
	<u>\$ 670,279</u>	<u>\$ 638,608</u>
Other noncurrent assets:		
Goodwill and other intangible assets	\$ 7,000	\$ 1,820
Accumulated amortization	<u>(1,757)</u>	<u>(1,370)</u>
	5,243	450
Deferred debt issuance costs	17,129	18,135
Deferred compensation investments	16,641	15,362
Other	<u>14,272</u>	<u>21,062</u>
	<u>\$ 53,285</u>	<u>\$ 55,009</u>
Other noncurrent liabilities, less current Portion:		
Accrued professional liability losses	\$ 199,655	\$ 195,822
Accrued pension costs	23,495	3,601
Other	<u>51,027</u>	<u>53,109</u>
	<u>\$ 274,177</u>	<u>\$ 252,532</u>

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Net Patient Accounts Receivable

	December 31	
	1999	1998
	<i>(in thousands)</i>	
Net patient accounts receivable:		
Gross patient accounts receivable	\$ 662,801	\$ 712,437
Allowances and advances under contractual arrangements	(434,391)	(472,351)
Allowance for uncollectible accounts	(102,421)	(109,404)
	\$ 125,989	\$ 130,682

Patient service revenues are shown net of contractual and charity care adjustments of \$944,651,000 in 1999 and \$947,111,000 in 1998.

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, 1999 and 1998 include net amounts due from Medicare (13% and 17%), Medicaid (12% and 12%), Blue Cross (13% and 17%), and other payors, (62% and 54%), respectively.

4. Investments

The DMC records investments in equity securities and debt securities at fair value. Fair value is determined based on quoted market prices. Investments are summarized as follows:

	December 31	
	1999	1998
	<i>(in thousands)</i>	
Cash and cash equivalents	\$213,865	\$170,273
United States Government obligations	156,282	205,625
Corporate bonds	71,909	123,020
Common stocks	214,569	255,228
Other investments	75,756	50,393
	\$732,381	\$804,539

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments (continued)

Investment return is summarized as follows:

	Year ended December 31	
	1999	1998
	<i>(in thousands)</i>	
Interest and dividends	\$ 40,376	\$38,471
Net realized gains	81,418	23,759
Change in net unrealized gains	(60,659)	(986)
Total investment return	\$ 61,135	\$61,244
Included in other revenue	\$ 43,690	\$29,751
Included in other income	70,222	26,834
Reported separately as change in unrealized gains	(59,769)	(2,594)
	54,143	53,991
Increase in temporarily restricted net assets	6,992	7,253
Total investment return	\$ 61,135	\$61,244

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.

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.

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	
	1999	1998
	<i>(in thousands)</i>	
Cash and cash equivalents	\$ 42,097	\$ 30,787
Current portion of assets whose use is limited	9,660	14,375
Assets whose use is limited or restricted, less current portion	703,703	819,264

The carrying amounts and fair values of long-term debt are as follows:

	December 31	
	1999	1998
	<i>(in thousands)</i>	
Carrying amount	\$608,255	\$616,684
Fair value	544,303	648,143

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Line of Credit

At December 31, 1999, The DMC had a \$60,000,000 revolving line of credit with three banks, which was to expire June 30, 2001, of which \$56,000,000 was unused.

On April 4, 2000, the DMC entered into a new agreement with the three banks to provide a \$24,000,000 revolving line of credit, which expires April 3, 2001. Interest on any borrowings will be determined at the date of the borrowing based on the banks' prime rate or comparable alternative rate. Under the terms of the revolving line of credit agreement, The DMC is required to meet certain monthly restrictive covenants as defined in the agreement related to unrestricted net liquid assets, operating results, capital expenditures, and cash flow. Management expects The DMC will be able to meet the covenant requirements.

7. Long-Term Debt and Leases

Long-term debt consists of the following:

	December 31	
	1999	1998
	<i>(in thousands)</i>	
Michigan State Hospital Finance Authority (MSHFA) bonds:		
Series 1988A and 1988B, interest at 8.1%, due 2010	\$ 2,575	\$ 6,845
Series 1991A, interest at 7.0% to 7.1%, due 2001	4,410	6,405
Series 1993A, interest at 5.55% to 6.5%, due 2018	110,245	110,670
Series 1993B, interest at 4.7% to 5.75%, due 2023	132,285	132,285
Series 1995, interest at 5.38% to 6.7%, due 2026	72,310	73,265
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	11,244	12,384
Notes payable and other obligations	3,320	4,104
	619,499	629,068
Less current portion	4,990	9,555
	\$614,509	\$619,513

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt and Leases (continued)

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 \$3,585,000 in 2000 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 \$86,180,000 at December 31, 1999, is considered to be extinguished for financial reporting purposes and will be paid from escrow funds.

Obligations under capital leases consist of Detroit Receiving's sublease of its hospital facility, DMC Centers, Inc.'s lease of certain building facilities, and several equipment leases. The Detroit Receiving sublease requires annual payments of \$1,000,000 through 2001 at which time Detroit Receiving has the option to purchase the hospital assets for one dollar. The capitalized value of these assets is amortized over their useful lives. The DMC Centers, Inc.'s building leases expire during various periods through 2012, and the related assets are amortized over the shorter of their useful lives or the term of the leases.

On February 17, 2000 The DMC issued an offer to retire, pay-off or otherwise provide for payment for a portion of the Series 1995 bonds. At the time the bonds were issued by Sinai Hospital in 1995, Sinai Hospital expected to use a portion of the bond proceeds to finance certain capital improvements and renovation projects at its hospital facilities. Following issuance of the bonds, Sinai Hospital became an affiliate of The DMC and, in February, 1999, The DMC decided to move the hospital operations from the Sinai Hospital campus to the Grace Hospital campus. Approximately \$40 million of the original proceeds remain unspent and are being held by the trustee at December 31, 1999. The DMC intends to request the Internal Revenue Service (IRS) to approve the use of approximately \$15 million for projects other than those originally designated, and intends to use the remaining \$25 million to fund the tender offer made on February 17, 2000. The DMC completed the tender offer on March 8, 2000.

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>	
2000	\$ 3,844	\$ 2,366
2001	7,330	2,648
2002	6,685	1,366
2003	8,060	1,371
2004	8,555	1,378
Thereafter	573,781	8,248
	\$608,255	17,377
Less amounts representing interest		6,133
		\$11,244

Interest paid was \$37,195,000 in 1999 and \$30,979,000 in 1998. Interest capitalized was \$1,721,000 in 1999 and \$4,909,000 in 1998, respectively. Expenses incurred under operating leases were \$19,516,000 in 1999 and \$20,864,000 in 1998.

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.

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.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Professional and General Liability Losses (continued)

Accrued professional liability losses are recorded at their estimated present value based on discount rates which average approximately 6.5% in 1999 and 1998. Professional liability expense was \$45,271,000 in 1999 and \$54,023,000 in 1998.

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.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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, 1999 and 1998, and a statement of the funded status as of December 31, 1999 and 1998.

	Year ended December 31	
	1999	1998
	<i>(in thousands)</i>	
Reconciliation of benefit obligation		
Benefit obligation at the beginning of year	\$ 647,578	\$544,234
Service cost	29,810	29,704
Interest cost	43,196	38,857
Actuarial (gain) loss	(123,868)	50,726
Curtailments	(12,469)	-
Benefits paid	(17,566)	(15,943)
Benefit obligation at end of year	<u>566,681</u>	<u>647,578</u>
Reconciliation of fair value of plan assets		
Fair value of plan assets at beginning of year	563,248	525,351
Actual return on plan assets	72,279	53,840
Benefits paid	(17,566)	(15,943)
Fair value of plan assets at end of year	<u>617,961</u>	<u>563,248</u>
Funded status at December 31	51,280	(84,330)
Unrecognized net actuarial (gain) loss	(75,003)	81,434
Unrecognized transition asset	-	(1,230)
Unrecognized prior service cost	228	525
Accrued benefit cost	<u>\$ (23,495)</u>	<u>\$ (3,601)</u>

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Pension Benefits (continued)

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

	Year ended December 31	
	1999	1998
	<i>(in thousands)</i>	
Service cost-benefits earned during the period	\$ 29,810	\$ 29,704
Interest cost on projected benefit obligation	43,196	38,857
Expected return on assets	(52,520)	(47,931)
Amortization of prior service cost	266	405
Recognition of actuarial gain	341	-
Amortization of transition asset	(1,231)	(4,317)
Net pension expense of defined benefit plan	19,862	16,718
Curtailment loss	32	-
Other pension plan (income) expense	(813)	1,247
Net pension expense	\$ 19,081	\$ 17,965

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

	December 31	
	1999	1998
Discount rate	8.00%	6.75%
Expected long-term rate of return on assets	9.00%	9.25%
Rate of increase in compensation levels	4.50%	4.50%

The decrease in the projected benefit obligation and unrecognized net actuarial loss in 1999 was due primarily to the increase in the discount rate and reduction in the workforce.

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.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Other Postretirement Employee Benefits

In addition to The DMC's pension plan, certain 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 in the consolidated financial statements:

	Year ended December 31	
	1999	1998
	<i>(in thousands)</i>	
Reconciliation of benefit obligation		
Benefit obligation at the beginning of year	\$ 19,595	\$ 18,926
Service cost	13	10
Interest cost	1,487	1,325
Participant contributions	548	301
Actuarial loss	1,416	785
Benefits paid	(2,652)	(1,752)
Benefit obligation at end of year	<u>20,407</u>	<u>19,595</u>
Reconciliation of fair value of plan assets		
Fair value of plan assets at beginning of year	2,312	2,353
Actual return on plan assets	229	147
Benefits paid	(117)	(188)
Fair value of plan assets at end of year	<u>2,424</u>	<u>2,312</u>
Funded status at December 31	(17,983)	(17,283)
Unrecognized net actuarial loss	699	900
Unrecognized prior service cost	2,074	762
Accrued benefit cost	<u>\$ (15,210)</u>	<u>\$ (15,621)</u>

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:

	Year ended December 31	
	1999	1998
	<i>(in thousands)</i>	
Service cost	\$ 13	\$ 10
Interest cost	1,487	1,325
Expected return on assets	(150)	(150)
Amortization of prior service cost	63	63
Recognition of actuarial loss (gain)	163	(87)
Net periodic postretirement benefit cost	\$1,576	\$1,161

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 6.92% for 1999 and is assumed to decrease uniformly to 5.0% in 2003 and remain at that level thereafter. The discount rate was 8.00% at December 31, 1999 and 6.75% at December 31, 1998.

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:

	<u>1-Percentage Point Increase</u>	<u>1-Percentage Point Decrease</u>
Effect on total of service and interest cost components	\$ 107	\$ (89)
Effect on postretirement benefit obligation	1,518	(1,125)

11. Contingencies

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, 1999 The DMC had commitments of \$41,000,000 for the purchase of property and equipment.

The Detroit Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. 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 the future income of Radius Health Care System, Inc.

13. 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, classified by function are as follows:

	Year ended December 31	
	1999	1998
	<u>(in thousands)</u>	
Health care services	\$1,459,542	\$1,483,413
Teaching	98,149	96,029
General and administrative	167,749	186,934
	<u>\$1,725,440</u>	<u>\$1,766,376</u>

14. Related Party Transactions

The DMC purchases services related to the operation of its information systems from an entity in which one of The DMC trustees is an employee. The DMC purchases for such information services amounted to \$36,312,000 and \$7,403,000, for the years ended December 31, 1999 and 1998, respectively. The DMC purchases employee health insurance from an entity in which it owns a one-third interest. Purchases for health insurance services amounted to \$30,910,000 and \$29,792,000 during the years ended December 31, 1999 and 1998, respectively. The DMC has transactions with other affiliated entities 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)

15. Impairment Charges

During 1998, The DMC reassessed the operations in its northwest region due to the continued operating losses which were incurred. As a result, management consolidated operations of Sinai Hospital at the Grace Hospital facility and abandoned the Sinai Hospital facility during fiscal 1999. In accordance with SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," Sinai at December 31, 1998 was considered an "asset to be disposed of" and an impairment loss of \$45,693,000 was recognized in fiscal 1998 for the building, improvements, fixed equipment and certain movable equipment.

During 1998, The DMC recorded a provision of \$8,996,000 for the asset impairment related to Health Care Centers – Detroit. Operations of the Health Care Centers – Detroit indicated that undiscounted cash flows from the Centers would be less than the carrying value of their long-lived assets, including goodwill.

16. Performance Improvement Plan

For the years ended December 31, 1999 and 1998, The DMC has incurred decreases in unrestricted net assets of \$150,267,000 and \$100,948,000, respectively. The decreases have resulted from declining payments for services rendered, excess facility capacity, an increased level of indigent care provided, and losses from ambulatory and physician practices. Since the fourth quarter of 1998, The DMC has been involved in developing restructuring plans to improve its operating performance. Such efforts have included the retention of a nationally recognized consulting firm to assist in the restructuring process and the development by The DMC of a business plan and strategy to address The DMC's financial performance.

As a result of restructuring activities during 1999, The DMC recorded a restructuring charge of approximately \$32,047,000, which is included in the statement of operations. The restructuring charge includes amounts related to employee severance costs, contract termination costs, and consulting fees. At December 31, 1999, The DMC had approximately \$6,119,000 of accrued restructuring costs. In addition, during 1999 The DMC sold its dialysis center assets and interests in certain dialysis partnerships for total proceeds of \$8,000,000. The DMC recognized a gain on the sale of these assets of \$6,639,000 which has been reflected in the statement of operations.

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

16. Performance Improvement Plan (continued)

DMC management's plan for fiscal 2000 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 requirements of The DMC. While there is no assurance that financial targets for fiscal 2000 will be achieved, based on current estimates, management believes that cash flow from operations, revolving 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 2000.