



COMBINED FINANCIAL STATEMENTS

Sierra Vista Regional Health Center, Inc. and Affiliates  
Years Ended June 30, 2010 and 2009  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Sierra Vista Regional Health Center, Inc. and Affiliates

Combined Financial Statements

Years Ended June 30, 2010 and 2009

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## Report of Independent Auditors

Board of Trustees  
Sierra Vista Regional Health Center, Inc.

We have audited the accompanying combined balance sheets of Sierra Vista Regional Health Center, Inc. and Affiliates (the Company) as of June 30, 2010 and 2009, and the related combined statements of operations, changes in net assets, and cash flows for the years then ended. These combined financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these combined 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 combined financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall combined financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Sierra Vista Regional Health Center, Inc. and Affiliates at June 30, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

*Ernst & Young LLP*

August 26, 2010

Sierra Vista Regional Health Center, Inc. and Affiliates

Combined Balance Sheets

	June 30	
	2010	2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 13,025,498	\$ 9,955,532
Short-term investments	3,912,883	7,691,258
Patient accounts receivable, net of allowance for doubtful accounts of \$1,477,000 and \$1,981,000 at June 30, 2010 and 2009, respectively	7,837,954	8,172,391
Inventories	2,099,777	2,179,075
Current portion of assets whose use is limited	702,005	672,065
AHCCCS SAVE Program Receivable	1,570,087	1,671,330
Prepaid expenses and other	2,564,238	2,367,211
Total current assets	31,712,442	32,708,862
Assets whose use is limited, net of current portion	3,183,414	3,138,614
Investments	34,609,886	25,084,877
Property and equipment, net	36,873,701	35,721,467
Deferred financing costs, net	605,595	670,994
Interests in affiliates/other	670,144	475,336
Total assets	\$ 107,655,182	\$ 97,800,150
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 5,139,861	\$ 4,517,675
Accrued compensation	3,863,422	3,697,052
Estimated third-party settlements	1,632,878	2,483,155
Current portion of long-term debt	1,389,805	1,272,256
Total current liabilities	12,025,966	11,970,138
Long-term debt, net of current portion	25,564,416	26,706,605
Professional and general liability and other	3,394,971	1,751,247
Total liabilities	40,985,353	40,427,990
Net assets:		
Unrestricted	66,501,261	57,144,577
Temporarily restricted	168,568	227,583
Total net assets	66,669,829	57,372,160
Total liabilities and net assets	\$ 107,655,182	\$ 97,800,150

*See accompanying notes.*

Sierra Vista Regional Health Center, Inc. and Affiliates

Combined Statements of Operations

	<b>Year Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
Revenues:		
Net patient service revenue	<b>\$97,698,585</b>	\$93,835,879
Other operating revenue	<b>1,382,914</b>	1,743,407
Total revenues	<b>99,081,499</b>	95,579,286
Expenses:		
Salaries and wages	<b>37,346,111</b>	36,678,720
Employee benefits	<b>7,497,793</b>	7,589,185
Supplies, services and other	<b>34,753,686</b>	31,477,330
Provision for doubtful accounts	<b>2,685,398</b>	2,912,686
Professional fees	<b>2,197,557</b>	1,551,507
Interest	<b>1,910,876</b>	1,928,032
Depreciation and amortization	<b>6,531,300</b>	6,072,262
Net loss on disposal of equipment	<b>43,375</b>	25,306
Total expenses	<b>92,966,096</b>	88,235,028
Operating income	<b>6,115,403</b>	7,344,258
Other income (loss):		
Investment income	<b>1,431,224</b>	1,360,597
Net unrealized gains (losses) on investments	<b>1,509,684</b>	(1,369,514)
Other nonoperating revenue	<b>187,103</b>	280,266
Total other income	<b>3,128,011</b>	271,349
Excess of revenues over expenses	<b>9,243,414</b>	7,615,607
Net assets released from restrictions used for purchase of property and equipment	<b>113,168</b>	70,057
Increase in unrestricted net assets	<b>\$ 9,356,582</b>	\$ 7,685,664

*See accompanying notes.*

Sierra Vista Regional Health Center, Inc. and Affiliates

Combined Statements of Changes in Net Assets

	<b>Year Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
Unrestricted net assets:		
Excess of revenues over expenses	<b>\$ 9,243,414</b>	\$ 7,615,607
Net assets released from restrictions used for purchase of property and equipment	<b>113,168</b>	70,057
Increase in unrestricted net assets	<b>9,356,582</b>	7,685,664
Temporarily restricted net assets:		
Grants and contributions	<b>54,255</b>	35,015
Net assets released from restrictions used for purchase of property and equipment	<b>(113,168)</b>	(70,057)
Decrease in temporarily restricted net assets	<b>(58,913)</b>	(35,042)
Increase in net assets	<b>9,297,669</b>	7,650,622
Net assets, beginning of year	<b>57,372,160</b>	49,721,538
Net assets, end of year	<b>\$66,669,829</b>	\$57,372,160

*See accompanying notes.*

Sierra Vista Regional Health Center, Inc. and Affiliates

Combined Statements of Cash Flows

	<b>Year Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Operating activities</b>		
Increase in net assets	\$ 9,297,669	\$ 7,650,622
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	6,531,300	6,072,262
Provision for doubtful accounts	2,685,398	2,912,686
Net loss on disposal of equipment	43,375	25,331
Amortization of bond discount	12,179	12,181
Net unrealized (gains) losses on investments	(1,509,684)	1,369,514
Changes in operating assets and liabilities:		
Patient accounts receivable	(2,350,961)	(2,245,882)
Inventories	79,298	(330,154)
Prepaid expenses and other receivables	(95,784)	(855,631)
Assets limited as to use, net	(74,740)	(76,496)
Investments, net	(4,236,950)	(10,241,068)
Accounts payable and accrued expenses	622,186	(1,718,280)
Accrued compensation	166,370	586,937
Estimated third-party payor settlements	(850,277)	1,257,456
Net cash provided by operating activities	<b>10,319,379</b>	<b>4,419,478</b>
<b>Investing activities</b>		
Purchases of property and equipment, net	(7,509,828)	(7,447,208)
Proceeds from sales of property and equipment	29,400	-
Decrease in interests in affiliates	101,753	105,409
Net cash used in investing activities	<b>(7,378,675)</b>	<b>(7,341,799)</b>
<b>Financing activities</b>		
Payments on long-term debt	(1,283,300)	(1,177,936)
Decrease in other financing activities	(231,162)	(172,946)
Increase in other liabilities	1,643,724	443,724
Net cash provided by (used in) financing activities	<b>129,262</b>	<b>(907,158)</b>
Net increase (decrease) in cash	<b>3,069,966</b>	<b>(3,829,479)</b>
Cash and cash equivalents, beginning of year	<b>9,955,532</b>	<b>13,785,011</b>
Cash and cash equivalents, end of year	<b>\$ 13,025,498</b>	<b>\$ 9,955,532</b>
<b>Supplemental disclosures of cash flow information</b>		
Cash paid for interest	<b>\$ 1,835,742</b>	<b>\$ 1,898,498</b>

See accompanying notes.

# Sierra Vista Regional Health Center, Inc. and Affiliates

## Notes to Combined Financial Statements

June 30, 2010

### **1. Organization**

Sierra Vista Regional Health Center, Inc. (the Hospital) is an Arizona not-for-profit corporation exempt from income taxes. The Hospital is an 81-bed acute care hospital that provides a full range of inpatient and outpatient services in Sierra Vista, Arizona, and Cochise County. Services range from the inpatient units of medical/surgical, intensive care, progressive care, telemetry, obstetrics, and NICU to an emergency room that serves as a base station for many emergency medical service providers. Other outpatient services include diagnostic, rehabilitation, surgical, hospice, durable medical equipment, infusion, imaging center, outpatient surgery center, and clinics. The existence of the full continuum of services allows the Hospital to function seamlessly and without interruption to patient care.

### **Combination**

The Hospital's affiliates include the Sierra Vista Community Hospital Foundation (the Foundation), the Sierra Vista Community Hospital Auxiliary (the Auxiliary), Arizona Family Care Associates, Inc. (AFCA), and High Desert Clinic Urgent & Occupational Care (High Desert). The accounts and transactions of the Foundation are combined with that of the Hospital. The Auxiliary, AFCA, and High Desert are accounted for under the equity method of accounting.

The Hospital's interest in High Desert was sold in January 2009.

The accompanying combined financial statements include the accounts of the Hospital and all affiliates after elimination of intercompany accounts and transactions.

### **2. Summary of Significant Accounting Policies**

#### **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. Estimates also affect the reported amounts of changes in net assets during the reporting period. Actual results could differ from those estimates.

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Cash and Cash Equivalents**

Cash and cash equivalents includes certificates of deposit with original maturities of three months or less when acquired.

**Patient Accounts Receivable**

The Hospital grants credit without collateral to its patients, most of whom are local residents who are insured under third-party payor agreements. The following table summarizes the percentage of gross accounts receivable from all payors as of June 30:

	<u>2010</u>	<u>2009</u>
Medicare	28%	32%
AHCCCS	23	24
Other commercial third party	42	38
Self-pay and other	7	6
	<u>100%</u>	<u>100%</u>

**Inventories**

Inventories, consisting of drugs, medical devices, and medical supplies, are stated at the lower of cost (first-in, first-out method) or market.

**Investments**

Investments with original maturities greater than three months but less than one year are classified as short-term investments. Investments with maturities greater than one year are classified as long-term investments.

Investments are carried at fair value based on quoted market values. Investment income or loss (including realized or unrealized gains and losses on investments, interest, and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law.

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Property and Equipment**

Property and equipment acquisitions are recorded at cost. Depreciation is computed using the straight-line method, and is provided over the following estimated useful lives for each class of depreciable asset:

	<u>Years</u>
Buildings and improvements	15-30
Land improvements	15-25
Equipment	3-10

**Deferred Financing Costs**

Certain costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized over the life of the related debt using the straight-line method, which approximates the effective-interest method.

**Restricted Net Assets**

The Hospital reports contributions of cash and other assets as temporarily or permanently restricted revenue if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, restricted net assets are reclassified to unrestricted net assets and reported in the combined statements of operations and changes in net assets as released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions. Donor restrictions have been imposed restricting usage of assets primarily for property and equipment and other purposes.

**Net Patient Service Revenue**

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. 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 the related services are rendered and adjusted in future periods as final settlements are determined.

## Sierra Vista Regional Health Center, Inc. and Affiliates

### Notes to Combined Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Other Operating Revenue**

Other operating revenue consists primarily of cafeteria sales, donations, equity changes in affiliates, and radiology professional fees.

##### **Excess of Revenues over Expenses**

The combined statements of operations include a measurement for excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets required using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

##### **Physician Income Guarantees**

The Hospital enters into agreements with nonemployed physicians that include minimum net collection guarantees. These guarantees arise out of a community need to recruit physicians in certain specialties to the areas surrounding the Hospital and provide a guaranteed level of income to the physicians for the first year of practice. The guarantee provides a buffer between the physician's actual collection on patient billings in this initial period and an agreed-upon income level based on the specialty. The physician is expected to practice in the area for a total period of three to four years. Over the period subsequent to the guarantee period, amounts paid to the physician during the guarantee period are ratably forgiven, resulting in income to the physicians in the years of forgiveness. The estimated amount of the liability for the Hospital's obligation under these guarantees is approximately \$863,000 and \$1,100,000 at June 30, 2010 and 2009, respectively.

## Sierra Vista Regional Health Center, Inc. and Affiliates

### Notes to Combined Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Recent Accounting Pronouncements**

In January 2010, an accounting standard was released to further define and improve fair value measurements and disclosures. This standard amends the guidance on fair value by adding new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also provides clarification for existing disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. The accounting standard is effective for the Company beginning July 1, 2009, except for the requirements to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which is effective for the Company's fiscal year beginning July 1, 2010. The adoption of this accounting standard did not have a material impact on the Company's combined financial statements.

In June 2009, the Financial Accounting Standards Board (FASB) established the Accounting Standards Codification (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements. Recognition of the Codification in the Company's combined financial statements was effective for interim and annual periods ending after September 15, 2009. The impact on the Hospital's combined financial statements only related to the references to accounting guidance disclosed in the notes to the combined financial statements.

In May 2009, an accounting standard was released relating to the accounting and disclosure of events or transactions that occur after the balance sheet date, but before the financial statements are issued. There are two types of subsequent events: recognized subsequent events, which provide additional evidence about conditions that existed at the balance sheet date, and nonrecognized subsequent events, which provide evidence about conditions that did not exist at the balance sheet date, but arose before the financial statements were issued. Recognized subsequent events are required to be recognized in the financial statements, and nonrecognized subsequent events are required to be disclosed. In the preparation of the accompanying combined financial statements, the Hospital has evaluated subsequent events through the date of issuance, August 26, 2010.

##### **Reclassification**

Certain reclassifications were made to the 2009 combined financial statements to conform to the classifications used in 2010. The reclassifications had no effect on the change in net assets or on net assets as previously reported.

## Sierra Vista Regional Health Center, Inc. and Affiliates

### Notes to Combined Financial Statements (continued)

#### **3. Net Patient Service Revenue**

Net patient service revenue is reported at estimated net realizable amounts from patients and third-party payors for services rendered. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

##### **Medicare**

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services rendered are paid at prospectively determined rates using a set fee schedule. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. As of June 30, 2010, the Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2007.

##### **Arizona Health Care Cost Containment System (AHCCCS)**

AHCCCS is Arizona's alternative to the Medicaid program and is designed to meet indigent health care needs. The Hospital receives both a percentage of charges adjusted each year for any rate increase and per diem rates depending on the AHCCCS plan payor and the nature of the services provided.

##### **Other Third-Party Payors**

The Hospital has also entered into payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

## Sierra Vista Regional Health Center, Inc. and Affiliates

### Notes to Combined Financial Statements (continued)

#### **4. Community Benefit and Charity Care**

##### **Traditional Charity Care**

In support of its mission and philosophy, the Hospital provides care to all patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The Hospital does not pursue collection of amounts determined to qualify as charity care. The costs of these services were approximately \$1,166,000 in fiscal 2010 and \$1,063,000 in fiscal 2009.

##### **Care for Undocumented Patients**

The Hospital provides care to patients who have entered the community illegally. The charges for these patients are partially reimbursed under Section 1011 of the Medicare Prescription Drug, Improvement and Modernization Act of 2003. The unreimbursed costs for serving these patients were approximately \$49,000 in fiscal 2010 and \$73,000 in fiscal 2009.

##### **Unpaid Costs of Public Programs**

Public programs such as AHCCCS provide for the poor and indigent. Public programs such as Medicare provide for the elderly. Public programs do not always cover the costs of providing these services. There were no unreimbursed costs of the AHCCCS program. The unreimbursed costs of the Medicare program were approximately \$10,789,000 in fiscal 2010 and \$10,768,000 in fiscal 2009.

##### **Other Community Benefit Programs**

Community benefit provided to the community includes the cost of providing services to other populations who may not qualify as poor; but may need special services and support. This type of community benefit includes the cost of programs for senior citizens such as health promotion and education, health clinics, and screenings. It also includes costs incurred by the Hospital for training health professionals such as medical residents, nursing students, and students in allied health professionals.

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**4. Community Benefit and Charity Care (continued)**

The Hospital also commits significant time and resources to endeavors and critical services which meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be financially viable. The development of these programs is based on a community health care assessment performed by an independent company. The current community outreach programs are:

Better Breathers Club	Bike Safety
Blood Pressure Checks	Cardiac Rehabilitation
Diabetes Support Group	Diabetes Education
Food Drives	Health Fairs
Hospice Bereavement Group	Mall Walkers Program
Parish Nurse Program	Perinatal Grief Support
Poison Safety Classes	Postpartum Depression Information
Power of Pink Breast Cancer	Prenatal Classes
Pulmonary Rehabilitation	Speakers Bureau
Smart Teen Eating Program	Smoke Support Group
Telecare Home Bound	Virtual Tour Kits for all Schools
Weight Management Program	Wellness Depot
Cholesterol Testing	Old Medication Disposal
VICAP space and supplies	H1N1 Awareness
Arthritis Programs	Chair Yoga
Water Safety	MRSA Awareness
Flue Precaution Programs	Kids Sports Teams First Aid Kits
Music Therapy	Sun Safety
Advanced Directives	Living Wills
Immunization Information	Bone Marrow Collection
Pulse Oxygen Tests	Body Mass Index
Southwest Snake Safety	Southwest Insect Safety
Arrhythmic Death Syndrom	Heart Safety

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**4. Community Benefit and Charity Care (continued)**

The Hospital also sponsors events in the community through other health and welfare organizations which promote healthy life styles and/or disease prevention/information; these include:

American Cancer Society	Forgach House (Battered Women/Children)
Little League	Good Neighbor Alliance (Men's Shelter)
United Way (numerous programs)	March of Dimes
Just Kids (clothing program)	Running Club
Youth Soccer Club	Senior Olympics
High School Scholarships	College Scholarships
State of Arizona Kids Care	American Heart Association
American Red Cross Blood Drives	VICAP
Project Graduation (drug/alcohol free evening for graduating seniors)	

**5. Investments and Assets Whose Use is Limited**

A summary of investments (carried at fair value based upon quoted market prices) at June 30 follows:

	<u>2010</u>	<u>2009</u>
Certificates of deposit	\$ 16,569,013	\$ 14,053,232
U.S. government agency and treasury securities	3,613,416	1,977,004
Municipal bonds	30,767	223,778
Corporate bonds	7,200,759	6,535,023
Common stocks	8,252,147	7,011,742
Mutual funds	2,201,557	1,771,566
Closed-end funds	197,200	191,400
Mortgage-backed securities	457,910	1,012,390
	<u>38,522,769</u>	<u>32,776,135</u>
Less short-term investments	3,912,883	7,691,258
	<u>\$ 34,609,886</u>	<u>\$ 25,084,877</u>

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**5. Investments and Assets Whose Use is Limited (continued)**

Assets whose use is limited represents assets held by a trustee under indenture agreements. Assets whose use is limited are carried at fair value, based upon quoted market prices. The debt reserve fund consists of U.S. government agency and treasury securities. The other funds consist of money market funds. The composition at June 30 follows:

	<u>2010</u>	<u>2009</u>
Assets held by trustee under bond indenture:		
Debt reserve fund	\$ 3,183,414	\$ 3,138,614
Bond principal fund	554,413	519,686
Bond interest fund	147,592	152,379
	<u>3,885,419</u>	<u>3,810,679</u>
Less current portion	702,005	672,065
	<u>\$ 3,183,414</u>	<u>\$ 3,138,614</u>

In 1998, the Hospital entered into agreements with a broker whereby the Hospital sold the future income stream pertaining to the Series 1997 Bond reserve fund and the Series 1997, 1996A, 1996B, and 1996C principal and interest funds of the respective bonds in exchange for fees totaling \$750,000. The terms of the agreements include provisions for termination penalties in certain events. The Hospital recorded the proceeds received as an other long-term liability which is being amortized over the terms of the agreements under the interest method. The unamortized balance was approximately \$275,000 and \$311,000 at June 30, 2010 and 2009, respectively.

## Sierra Vista Regional Health Center, Inc. and Affiliates

### Notes to Combined Financial Statements (continued)

#### 6. Fair Value Measurements

The Hospital utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- *Level 1* – Pricing is based on observable inputs such as quoted prices in active markets. Financial assets and liabilities in Level 1 generally include U.S. government agency and treasury securities and listed equities.
- *Level 2* – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include asset-backed securities, corporate bonds and loans, municipal bonds, forward contracts, future contracts, interest and credit swap agreements, options, and interest rate swaps.
- *Level 3* – Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are identified in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

- (a) *Market approach* – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- (b) *Cost approach* – Amount that would be required to replace the service capacity of an asset (replacement cost).

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**6. Fair Value Measurements (continued)**

(c) *Income approach* – Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing, and excess earnings models).

	<b>Balance at June 30</b>	<b>Quoted Prices In Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Valuation technique (a,b,c)</b>
<b>June 30, 2010</b>					
Cash and cash equivalents	\$ 8,074,240	\$ –	\$ –	\$ –	(a)
Money Market funds	5,653,263	5,653,263	–	–	(a)
Certificates of deposit	16,569,013	–	16,569,013	–	(a)
U.S. government securities	6,796,830	6,796,830	–	–	(a)
Municipal bonds	30,767	–	30,767	–	(a)
Corporate bonds	7,200,759	–	7,200,759	–	(a)
Common stocks	8,252,147	8,252,147	–	–	(a)
Mutual funds	2,201,557	–	2,201,557	–	(a)
Closed-end funds	197,200	–	197,200	–	(a)
Mortgage-backed securities	457,910	–	457,910	–	(c)
<b>June 30, 2009</b>					
Cash and cash equivalents	4,851,205	4,851,205	–	–	(a)
Money Market funds	5,776,392	5,776,392	–	–	(a)
Certificates of deposit	14,053,232	–	14,053,232	–	(a)
U.S. government securities	5,115,618	5,115,618	–	–	(a)
Municipal bonds	223,778	–	223,778	–	(a)
Corporate bonds	6,535,023	–	6,535,023	–	(a)
Common stocks	7,011,742	7,011,742	–	–	(a)
Mutual funds	1,771,566	–	1,771,566	–	(a)
Closed-end funds	191,400	–	191,400	–	(a)
Mortgage-backed securities	1,012,390	–	1,012,390	–	(c)

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**7. Property and Equipment**

A summary of property and equipment at June 30 follows:

	<b>2010</b>	<b>2009</b>
Land and land improvements	<b>\$ 2,832,263</b>	\$ 2,702,748
Buildings, building improvements, and fixed equipment	<b>37,094,087</b>	32,706,261
Major and minor equipment	<b>42,200,470</b>	39,160,772
	<b>82,126,820</b>	74,569,781
Less accumulated depreciation	<b>46,863,678</b>	40,503,957
	<b>35,263,142</b>	34,065,824
Construction in progress	<b>1,610,559</b>	1,655,643
	<b>\$ 36,873,701</b>	\$ 35,721,467

The Hospital capitalized interest cost in the amount of \$0 and \$45,890 in 2010 and 2009, respectively.

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**8. Long-Term Debt**

A summary of long-term debt as of June 30 follows:

	<u>2010</u>	<u>2009</u>
Industrial Development Authority Hospital Refunding Bonds, Series 2003, term bonds in the original amount of \$2,670,000 at 6.00% fixed interest rate, maturing in December 2021, secured by the Hospital's land, buildings, and equipment	<b>\$ 2,670,000</b>	\$ 2,670,000
Industrial Development Authority Hospital Revenue Bonds, Series 2001, term bonds in the original amount of \$6,625,000 at 7.75% fixed interest rate, maturing in December 2030, secured by the Hospital's land, buildings, and equipment	<b>5,566,524</b>	5,721,117
Industrial Development Authority Hospital Revenue Refunding Bonds, Series 1999A, term bonds in the original amount of \$8,320,000 at 6.2% fixed interest rate, maturing in December 2021, secured by the Hospital's land	<b>7,216,374</b>	7,424,599
Industrial Development Authority Hospital Revenue Bonds, Series 1997, term bonds in the original amount of \$6,500,000 at 6.45% fixed interest rate, maturing in December 2017, secured by the Hospital's land, buildings, and equipment	<b>3,250,000</b>	3,555,000
Industrial Development Authority Hospital Revenue Refunding Bonds, Series 1996A, term bonds in the original amount of \$9,010,100 at 6.75% fixed interest rate, maturing in December 2026, secured by the Hospital's land, buildings, and equipment	<b>7,550,000</b>	7,760,000
Capital lease for equipment, monthly payments of principal and interest through July 2014, interest fixed at notes ranging from 3.9% to 5.5%	<b>701,323</b>	848,145
	<b>26,954,221</b>	27,978,861
Less current portion	<b>1,389,805</b>	1,272,256
	<b>\$ 25,564,416</b>	\$ 26,706,605

Sierra Vista Regional Health Center, Inc. and Affiliates

Notes to Combined Financial Statements (continued)

**8. Long-Term Debt (continued)**

Future aggregate principal payments on long-term debt as of June 30, 2010, follow:

2011	\$ 1,389,805
2012	1,146,922
2013	1,176,451
2014	1,158,145
2015	1,220,000
Thereafter	21,010,000
	<u>27,101,323</u>
Less unamortized discount	147,102
	<u>\$ 26,954,221</u>

Pursuant to the terms of the bond indentures, the Hospital is required to maintain amounts on deposit with a trustee which may only be used to satisfy obligations as permitted by the trust agreements. Such deposits are included in assets whose use is limited in the accompanying combined balance sheets.

The Hospital is subject to certain financial covenants which have been complied with for the year ended June 30, 2010. In addition, the indenture places certain restrictions on the incurrence of additional indebtedness and the sale or acquisition of property.

**9. Lease Commitments**

As of June 30, 2010, future minimum lease payments due under existing, noncancelable operating leases for buildings, equipment, and medical devices are as follows:

2011	\$ 1,176,133
2012	915,566
2013	830,314
2014	226,991
	<u>\$ 3,149,004</u>

## Sierra Vista Regional Health Center, Inc. and Affiliates

### Notes to Combined Financial Statements (continued)

#### **10. Professional and General Liability Coverage**

The Hospital is insured for professional liability under a claims-made policy with no deductible per claim. An unlimited tail is in place for all claims prior to July 2006. The limit of liability is \$11,000,000 per claim with a \$20,000,000 aggregate limit. In addition, the Hospital has general and umbrella liability coverage on a claims-made basis with a \$5,000,000 aggregate limit.

#### **11. Employee Benefit Plan**

The Hospital has a 403(b) employee benefit plan (the Plan). Under the terms of the Plan, the Hospital matches eligible participant contributions from 2.5% to 4.5% of gross pay based upon years of service as defined in the Plan agreement. Eligible participants must contribute at least 2.5% to receive the employer match. Participants are 100% vested in the value of their account attributable to their contributions and vest in the value of the account attributable to the employer's contributions over a five-year period. The Hospital's contributions to the Plan were approximately \$589,000 and \$519,000 for the years ended June 30, 2010 and 2009, respectively.

#### **12. Commitment and Contingencies**

##### **Commitment**

The Hospital has an unrecorded liability to the City of Sierra Vista to extend the road at Colonia de Salud. The City is not requiring the Hospital to complete the road at this time, but will require it at some future date based upon traffic flow. The Hospital will be responsible for one half of the cost to construct the road. Since this will occur at some future unknown date, it is not possible to estimate an actual liability at this time.

##### **Health Care Regulatory Environment**

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, and reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Hospital is in

## Sierra Vista Regional Health Center, Inc. and Affiliates

### Notes to Combined Financial Statements (continued)

#### 12. Commitment and Contingencies (continued)

compliance with fraud and abuse as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

#### Litigation

The Hospital is party to pending or threatened lawsuits arising out of, or incident to, its ordinary course of business for which it carries professional liability and other insurance coverages. In management's opinion, upon consultation with legal counsel, these matters will not have a material adverse effect on the Hospital's financial position.

#### 13. Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services for the years ended June 30 were as follows:

	<u>2010</u>	<u>2009</u>
Health care services	\$ 62,982,426	\$ 65,823,829
General and administrative	29,983,670	22,411,199
	<u>\$ 92,966,096</u>	<u>\$ 88,235,028</u>

#### 14. Agreement with Carondelet Health Network

During fiscal 2010, the Company entered into a two year Integrative Network Agreement with the Carondelet Health Network (CHN), who is a member of Ascension Health, the nation's largest nonprofit health care system. The Company and CHN through this agreement will focus on improving clinical and quality outcomes as well as driving operational efficiencies.

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