

CONSOLIDATED FINANCIAL STATEMENTS AND  
OTHER FINANCIAL INFORMATION  
CAMC Health System, Inc. and Subsidiaries  
Years ended December 31, 2003 and 2002

CAMC Health System, Inc. and Subsidiaries

Consolidated Financial Statements  
and Other Financial Information

Years ended December 31, 2003 and 2002

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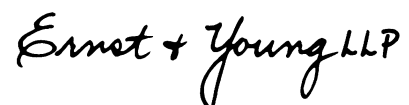
## Report of Independent Auditors

Board of Directors  
CAMC Health System, Inc.

We have audited the accompanying consolidated balance sheets of CAMC Health System, Inc. and subsidiaries (the System) as of December 31, 2003 and 2002, 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 System's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of CAMC Health Education and Research Institute, Inc. (the Institute), a wholly owned subsidiary, which statements reflect total assets of \$5,329,000 and \$4,062,000 as of December 31, 2003 and 2002, respectively, and total revenues of \$13,338,000 and \$11,449,000 for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Institute, is based solely on the report of the other auditors.

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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the System as of December 31, 2003 and 2002, and the results of its operations, changes in net assets, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.



April 2, 2004

CAMC Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

	<b>December 31</b>	
	<b>2003</b>	<b>2002</b>
	<i>(in thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 13,094	\$ 39,634
Short-term investments	37,301	33,329
Current portion of assets limited as to use	8,736	5,381
Patient receivables, net of allowances for uncollectible accounts of \$10,374 in 2003 and \$11,079 in 2002	88,170	81,718
Other receivables	8,825	8,152
Estimated amounts due from third-party payors	4,098	4,396
Inventories	7,195	8,862
Prepaid expenses and other	6,790	3,893
Total current assets	<u>174,209</u>	<u>185,365</u>
Assets limited as to use	197,313	183,315
Property, plant and equipment:		
Land	20,232	13,332
Buildings and improvements	226,440	217,897
Equipment	342,374	339,359
Construction in progress	12,278	3,226
	<u>601,324</u>	<u>573,814</u>
Less accumulated depreciation	(417,630)	(406,663)
Total property, plant and equipment, net	<u>183,694</u>	<u>167,151</u>
Other assets	13,137	14,546
Total assets	<u>\$ 568,353</u>	<u>\$ 550,377</u>

	<b>December 31</b>	
	<b>2003</b>	<b>2002</b>
	<i>(in thousands)</i>	
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 48,695	\$ 46,192
Accrued payroll and payroll related expenses	24,500	25,301
Lines of credit	-	13,000
Current maturities of long-term debt	9,622	6,388
Total current liabilities	<u>82,817</u>	<u>90,881</u>
Long-term liabilities:		
Long-term debt	232,138	241,160
Postretirement benefits other than pensions	16,767	17,028
Self-insurance reserves	20,927	24,725
Other	5,593	3,545
Total long-term liabilities	<u>275,425</u>	<u>286,458</u>
<b>Total liabilities</b>	<b>358,242</b>	<b>377,339</b>
Minority interest	(879)	(1,367)
Net assets:		
Unrestricted	191,541	158,652
Temporarily restricted	5,012	1,931
Permanently restricted	14,437	13,822
Total net assets	<u>210,990</u>	<u>174,405</u>
Total liabilities and net assets	<u><u>\$ 568,353</u></u>	<u><u>\$ 550,377</u></u>

*See accompanying notes.*

CAMC Health System, Inc. and Subsidiaries

Consolidated Statements of Operations

	<b>Years ended December 31</b>	
	<b>2003</b>	<b>2002</b>
	<i>(in thousands)</i>	
Unrestricted revenue and other support:		
Net patient service revenue	\$ 534,939	\$ 500,549
Other revenue	29,119	32,323
Change in fair value of derivatives	4,925	(6,251)
Investment income, net	6,264	2,435
Net assets released from restrictions	682	2,096
Total unrestricted revenue and other support	<u>575,929</u>	531,152
Expenses:		
Salaries and wages	202,662	204,769
Employee benefits	60,050	55,790
Professional compensation and fees	7,861	8,966
Supplies and other	206,389	184,466
Depreciation and amortization	28,535	31,442
Provision for uncollectible accounts	32,250	34,784
Medicaid provider tax	11,777	10,304
Interest and debt expense	12,256	10,976
Loss on debt refinancing	-	21,839
Total expenses	<u>561,780</u>	563,336
Excess (deficiency) of revenues over expenses	<u>14,149</u>	(32,184)
Other changes in unrestricted net assets:		
Net unrealized gains (losses) on investments	18,540	(5,859)
Change in derivative hedge valuation	-	(497)
Net assets released from restrictions for capital expenditures	99	394
Contributions for capital expenditures	101	26
Increase (decrease) in unrestricted net assets	<u>\$ 32,889</u>	<u>\$ (38,120)</u>

See accompanying notes.

CAMC Health System, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets

	<b>Years ended December 31</b>	
	<b>2003</b>	<b>2002</b>
	<i>(in thousands)</i>	
Unrestricted net assets:		
Excess (deficiency) of revenue over expenses	\$ 14,149	\$ (32,184)
Net unrealized gains (losses) on investments	18,540	(5,859)
Change in derivative hedge valuation	-	(497)
Net restricted assets released from restrictions for capital expenditures	99	394
Contributions for capital expenditures	101	26
Increase (decrease) in unrestricted net assets	<u>32,889</u>	<u>(38,120)</u>
Temporarily restricted net assets:		
Contributions, net	926	733
Investment income, net	245	929
Net realized/unrealized gains (losses) on investments	3,221	(5,531)
Net assets released from restrictions for:		
Programs	(1,212)	(2,096)
Capital expenditures	(99)	(394)
Increase (decrease) in temporarily restricted net assets	<u>3,081</u>	<u>(6,359)</u>
Permanently restricted net assets:		
Contributions	615	786
Increase in permanently restricted net assets	<u>615</u>	<u>786</u>
Increase (decrease) in net assets	36,585	(43,693)
Net assets, beginning of year	174,405	218,098
Net assets, end of year	<u>\$ 210,990</u>	<u>\$ 174,405</u>

*See accompanying notes.*

# CAMC Health System, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

	Years ended December 31	
	2003	2002
	<i>(in thousands)</i>	
<b>Cash flows from operating activities</b>		
Increase (decrease) in net assets	\$ 36,585	\$ (43,693)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Loss on debt refinancings	-	21,839
Change in fair value of derivatives	(4,925)	6,748
Gain on sale of Plateau Medical Center	-	(244)
Depreciation and amortization	28,535	31,442
Provision for uncollectible accounts	32,250	34,784
Net realized/unrealized (gains) losses on investments	(23,252)	13,686
Net restricted contributions and investment income	(1,786)	(1,611)
Minority interest	(488)	(9)
Change in assets and liabilities:		
Patient receivables	(38,702)	(25,791)
Other receivables	(673)	(1,972)
Inventories, prepaid expenses, and other	(1,230)	(2,538)
Estimated amounts due from/to third-party payors	298	(3,538)
Accounts payable and accrued expenses	7,426	(8,169)
Accrued payroll and payroll-related expenses	(801)	5,606
Other liabilities	(1,522)	(3,268)
Net cash provided by operating activities	<u>31,715</u>	<u>23,272</u>
<b>Cash flows from investing activities</b>		
Capital expenditures, net	(45,078)	(27,262)
Proceeds from the sale of Plateau Medical Center	-	8,229
Change in assets limited as to use, net	5,897	(36,458)
Increase in short-term investments	(3,972)	(13,166)
Change in minority interest	488	9
Change in other assets	1,486	1,831
Net cash used in investing activities	<u>(41,179)</u>	<u>(66,817)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of long-term debt	-	167,550
Principal payments on debt and other liabilities	(5,788)	(122,758)
Net restricted contributions and investment income	1,788	1,611
Payment of debt issuance costs	(76)	(8,669)
Payments on line of credit	(13,000)	-
Borrowings under lines of credit	-	13,000
Net cash (used in) provided by financing activities	<u>(17,076)</u>	<u>50,734</u>
Net (decrease) increase in cash and cash equivalents	(26,540)	7,189
Cash and cash equivalents, beginning of year	39,634	32,445
Cash and cash equivalents, end of year	<u>\$ 13,094</u>	<u>\$ 39,634</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid during the year for interest	<u>\$ 11,777</u>	<u>\$ 12,289</u>

*See accompanying notes.*

# CAMC Health System, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

December 31, 2003 and 2002

(in thousands)

### 1. Organization

CAMC Health System, Inc. (the Parent), formerly Camcare, Inc., is a West Virginia nonprofit corporation exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (the Code). As the parent holding company, the Parent provides general guidance and strategic direction for the following subsidiaries (collectively the System):

*Charleston Area Medical Center, Inc. (CAMC)*—a West Virginia nonprofit corporation that owns and operates the General, Memorial, and Women and Children's Hospitals.

*Charleston Area Medical Center Foundation, Inc. (the Foundation)*—a West Virginia nonprofit corporation established for the purpose of raising funds for CAMC.

*Heritage Health System, Inc. (Heritage)*—a West Virginia nonprofit corporation that owned and operated Plateau Medical Center, Inc. (Plateau) through June 25, 2002 and Heritage Management Services, Inc. and Heritage Medical Associates, Inc. On June 25, 2002, management executed a sales agreement (the agreement) with Community Health Systems (CHS), a for-profit health care provider. CHS purchased substantially all of the net assets of Plateau, except for the patient receivables and the Series 2000 Revenue Bonds (see Note 6), for \$8,230. Heritage realized a gain on the sale of its facilities in 2002 of approximately \$244. Sale of Plateau to a for-profit organization required defeasance of the Series 2000 Revenue Bonds in order to maintain the tax-exempt status of the bonds. Plateau did not have sufficient funds to defease the bonds and required an equity transfer from CAMC of \$18,864 in order to defease the Plateau bonds. The Plateau bonds were legally defeased on September 24, 2002, and Plateau incurred a loss of approximately \$5,636 related to the defeasance of the bonds. Heritage Management Services, Inc. and Heritage Medical Associates, Inc. discontinued operations in 2002.

*CAMC Health Education and Research Institute, Inc. (the Institute)*—a West Virginia nonprofit corporation established for the purpose of managing, promoting, and conducting medical education and research programs.

*Integrated Health Care Providers, Inc. (Integrated)*—a West Virginia corporation established for the purpose of providing physician services.

*Braxton County Memorial Hospital, Inc. (Braxton)*—a West Virginia nonprofit corporation that operates a community hospital in rural West Virginia.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **2. Significant Accounting Policies**

##### **Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of the Parent and the aforementioned subsidiaries. All significant intercompany transactions and balances have been eliminated.

##### **Cash, Cash Equivalents, and Short-Term Investments**

Cash and cash equivalents represent cash and temporary investments with original maturities of three months or less. Short-term investments represent primarily debt securities with original maturities extending beyond three months that management has identified as available to meet current operating needs.

##### **Patient Receivables and Net Patient Service Revenues**

Patient receivables and net patient service revenues are derived primarily from services rendered in the System's local geographic regions. Patient receivables consist of amounts due from third-party payors, including federal and state indemnity and managed care programs, managed care health plans and commercial insurance companies, and individual patients for health care services rendered. The System does not require collateral or other security on its patient receivables.

In 2003 and 2002, approximately 92% and 93%, respectively, of consolidated net patient service revenue was derived from third-party payment programs (Medicare, Medicaid, Public Employees' Insurance Agency (PEIA), workers' compensation, and various other arrangements), which reimburse the System at amounts that are less than established charges. Net patient service revenue reflects the estimated net realizable amounts due from third-party payors for services rendered, including estimated retroactive adjustments under reimbursement agreements.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 2. Significant Accounting Policies (continued)

Net patient service revenues from the Medicare and Medicaid programs account for approximately 37% and 11%, respectively, of the System's net patient service revenue for the year ended December 31, 2003 and 39% and 14%, respectively, for the year ended December 31, 2002. Payments received under the reimbursement arrangements with Medicare and Medicaid are subject to retroactive audit and adjustment. Provision has been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between the standard charges for services and estimated total payments to be received from third-party payors. Estimated settlements are accrued in the period the related services are rendered and adjusted in future periods as final settlements are determined. Settlement of prior year cost reports and revisions to prior year settlement estimates had the effect of increasing net patient service by approximately \$2,900 in 2003 and decreasing net patient service revenue by approximately \$11,075 in 2002. Laws and regulations governing these programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimated settlements will change by a material amount in the near term. Management believes that adequate provisions have been made for reasonable adjustments that may result from such final settlements. The System believes it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The approximate percentage of patient receivables by type of payor as of December 31 is as follows:

	2003	2002
Medicare	23%	21%
Commercial insurance	34	34
Other third-party payment programs	30	22
Medicaid	7	14
Self-pay	3	2
PEIA	3	7
	100%	100%

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

Management maintains an allowance for doubtful accounts to reserve for estimated credit losses based on the length of time the account has been past due and the historical experience with the payor. Uncollectible accounts that are the responsibility of patients are considered bad debts. Uncollectible accounts that are the responsibility of third-party payers are offset against net patient service revenues.

#### **Charity Care**

The System provides care to patients who meet certain criteria under its charity care policies without charge or at amounts less than its established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue (see Note 3). The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under the System's charity care policies.

#### **Pledges Receivable**

The Foundation has \$200,000 as pledges receivable at December 31, 2003. The amount to be received in one year is \$67,000. The amount to be received in one to five years is \$133,000. These amounts are included in other receivables in the consolidated financial statements.

#### **Supplies Inventory**

Supplies inventory is valued at the lower of cost on a first-in, first-out (FIFO) basis or market.

#### **Assets Limited as to Use/Investments**

Investments in equity securities with readily determinable 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 determined by the average cost method, including other-than-temporary losses on unrestricted nontrading investments, are included in excess of revenues over expenses. Net unrealized gains and losses are recorded as changes in net assets in the accompanying consolidated statements of changes in net assets.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

The System reviews non-trading investments for impairment conditions that indicate that an other-than-temporary decline in market value has occurred. In conducting this review, various factors are considered which, individually or in combination, indicate that a decline is other than temporary and that a reduction of the carrying value is required. These factors include specific information pertaining to an individual company or a particular industry. Based on this review, other than temporary losses of \$3,254 were recorded in 2002, and are included in investment income, net in the consolidated statement of operations for the year ended December 31, 2002.

The Foundation's investments are commingled among unrestricted, temporarily restricted, and permanently restricted funds to obtain maximum use of funds and higher interest rates on short-term investments. The Foundation's investment income from unrestricted, temporarily restricted, and permanently restricted funds is allocated to unrestricted and temporarily restricted funds based on the fund's percentage of total net assets.

Investments in limited partnerships are accounted for utilizing the cost method, as the Foundation has virtually no influence over partnership operating and financial policies. The carrying value of life insurance contracts represents the cash surrender value of such contracts.

#### **Derivatives**

CAMC has entered into floating-to-fixed and floating-to-floating interest rate swap agreements and an interest rate cap agreement in connection with its debt management program. Under Financial Accounting Standards Board Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (Statement 133), and SOP 02-2, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations*, adopted in 2002, CAMC records its derivative instruments as either assets or liabilities in the accompanying consolidated balance sheets at fair value. The impact of adopting SOP 02-2 did not impact the System's accounting and financial statement presentation for derivatives, as the provisions of SOP 02-2 were consistent with the System's historical practices. The accounting for changes in fair value (i.e., unrealized gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. The effective portion of the unrealized gain or loss on the derivative instruments qualifying for hedge treatment is reported as an other change in unrestricted net assets. For derivatives not designated in a hedge relationship, the gain or loss is recognized as derivative gain/loss, and the change in fair value is recorded in excess of revenues over expenses.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

##### **Property, Plant, and Equipment**

Amounts capitalized as part of land, buildings, and equipment, including additions and improvements to existing facilities, are recorded at acquisition cost, including applicable internal labor costs capitalized during construction. During 2003 and 2002, approximately \$1,038 and \$925, respectively, of internal labor costs were capitalized related to construction projects.

Depreciation, including amortization of assets recorded under capital leases, is recorded on the straight-line method over the estimated useful lives of the buildings and improvements (generally 10 to 40 years) and equipment (generally 3 to 20 years). Upon retirement or disposal of assets, the asset and accumulated depreciation accounts are adjusted, and any gain or loss is recorded in the consolidated statement of operations. Maintenance costs and repairs are expensed as incurred.

The System continually reviews the recoverability of the carrying value of long-lived assets as prescribed in Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The System also reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Any write-downs due to impairment are charged to operations at the time impairment is identified.

##### **Contributions**

Contributions are recognized in the period cash is received or the period in which an unconditional promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. Gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations.

For the Institute, donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements. For the Foundation, donor-restricted contributions whose restrictions are met within the same year as received are reported as net assets released from restrictions in the accompanying consolidated financial statements.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

##### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are available primarily for cancer-related initiatives, research, education and scholarship programs, and the care of indigent patients. Permanently restricted net assets are comprised of endowment funds, which are restricted in perpetuity, and the income is to be used primarily for clinical and education programs.

##### **Self-Insurance Health Plan**

The System has a self-insurance program for employee health insurance. Payments for claims by employees are remitted to a third-party administrator to provide for the payment of actual claims and administrative fees. Estimated unpaid claims, including amounts for incurred but not reported claims, are included in accounts payable and other accrued expenses.

##### **Minority Interest**

CAMC is a general partner in two medical office building partnerships, each being organized as general partnerships. CAMC owns a 63.9% interest in the General Division Medical Office Building Partnership and an 89% interest in the Women and Children's Medical Office Building Partnership. Individual practicing physicians or physician medical corporations own the remaining residual interest in these partnerships. The residual interest is reflected as minority interest in the consolidated financial statements.

##### **Excess of Revenues Over Expenses**

The consolidated statements of operations 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 other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets), and the effective portion of unrealized gains and losses of derivative investments designated as hedges.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

##### **Income Taxes**

Integrated follows the provisions of SFAS No. 109, *Accounting for Income Taxes*. At December 31, 2003 and 2002, Integrated had recorded a deferred tax asset of approximately \$3,343 and \$4,287, respectively, representing net operating loss (NOL) carryforwards. This deferred tax asset has been fully reserved by a valuation allowance in the accompanying consolidated balance sheets due to the uncertainty of Integrated's ability to generate future taxable income.

CAMC, the Foundation, Heritage, the Institute, and Braxton are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable state statutes. Accordingly, no provision for income taxes is made in the accompanying consolidated financial statements.

##### **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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Adjustments to estimates are recorded, as appropriate, in periods in which they are determined.

##### **Reclassifications**

Certain reclassifications have been made to the 2002 consolidated financial statements to conform to the 2003 presentation. Such reclassifications did not affect previously reported deficiency of revenues over expenses or decrease in net assets.

CAMC Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**3. Net Patient Service Revenue**

Net patient service revenue for the years ended December 31, 2003 and 2002, consists of the following:

	2003				2002
	CAMC	Integrated	Braxton	Total	
Gross patient service billings	\$ 915,873	\$ 27,538	\$ 16,649	\$ 960,060	\$ 871,249
Charity care allowances	(21,162)	-	(71)	(21,233)	(15,690)
Contractual allowances	(394,490)	(10,014)	(5,730)	(410,234)	(364,265)
Medicaid disproportionate share enhancement program revenue	5,862	-	484	6,346	9,255
Net patient service revenue	\$ 506,083	\$ 17,524	\$ 11,332	\$ 534,939	\$ 500,549

The System has agreements with third-party payors that provide for payments at amounts that differ from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

**Medicare**

Inpatient acute care services rendered to Medicare program beneficiaries and medical education, disproportionate share reimbursement, and capital costs are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are reimbursed at prospectively determined rates per visit based primarily on ambulatory payment classification. Some inpatient non-acute services, certain outpatient services, and a percentage of bad debt costs related to Medicare beneficiaries are substantially paid based on a cost reimbursement methodology. The System is primarily reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. Classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Medicare program.

The Medicare cost reports for CAMC have been audited by the Medicare fiscal intermediary through December 31, 1999. Braxton has been audited through December 31, 2000.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **3. Net Patient Service Revenue (continued)**

##### **Medicaid**

Payments for inpatient services rendered to Medicaid program beneficiaries are primarily reimbursed on a prospective payment system. Outpatient services rendered to Medicaid program beneficiaries are reimbursed based on a predetermined fee schedule.

##### **PEIA**

Inpatient services rendered to PEIA subscribers are reimbursed on a prospective payment system. Outpatient services rendered to PEIA subscribers are reimbursed based on a fee schedule, with no retroactive adjustment.

##### **Other**

The System has also entered into payment agreements with certain commercial insurance carriers, preferred provider organizations (PPOs) and health maintenance organizations (HMOs). The primary basis for payment under the commercial, HMO, and PPO arrangements is negotiated rates.

##### **Medicaid Disproportionate Share Enhancement Program**

Under the West Virginia Medicaid Disproportionate Share Enhancement Program, funds designated by the West Virginia legislature for disproportionate share hospitals are distributed based on, among other things, each particular hospital's Medicaid inpatient activity and total operating expenses compared to other hospitals in the state. During 2003 and 2002, the System recorded \$6,346 and \$9,255, respectively, in reimbursement from the disproportionate share program. This reimbursement has been included in net patient service revenue in the accompanying consolidated statements of operations. Funds received from this program are subject to retroactive adjustment. The State of West Virginia renewed the program through June 30, 2004.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **3. Net Patient Service Revenue (continued)**

The State of West Virginia Disproportionate Share Hospital (DSH) State Plan was amended to provide for a settlement process among participating hospitals. The state has not completed a settlement process for the years subsequent to 1996. The Bureau for Medical Services of the State of West Virginia Department of Health and Human Resources (the Bureau) has contracted with a third-party vendor to assist with the audit settlement process for the Disproportionate Share Hospital State Plan. The laws and regulations governing the DSH settlement process are complex, involving statistical data from all participating hospitals, and subject to interpretation. Accordingly, the System is not able to estimate the possible losses that could arise upon completion of the DSH settlement process. The ultimate resolution of the settlement process could materially impact the System's future results of operations or cash flows in a particular period.

#### **Broad Based Health Care Related Tax**

The West Virginia Broad Based Health Care Related Tax (formerly the West Virginia Health Care Provider Medicaid Enhancement Tax) of 1993 assesses a tax on net patient service revenue at rates varying from 1.75% to 5.5% depending on the type of services provided. This tax totaled \$11,777 and \$10,304 during 2003 and 2002, respectively, and is reflected as an operating expense in the accompanying consolidated statements of operations.

CAMC Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**4. Assets Limited as to Use**

Assets limited as to use consist of the following as of December 31:

	<b>2003</b>	<b>2002</b>
Board-designated funds:		
Cash and cash equivalents	\$ 940	\$ 934
Corporate stocks	65,380	33,915
Limited partnerships	10,255	10,255
Mutual funds	24,307	27,308
	<b>100,882</b>	72,412
Self-insurance:		
Cash and cash equivalents	2,387	8,226
Government obligations	8,948	8,628
Corporate bonds	183	1,021
Corporate stocks	15,244	7,893
Mutual funds and other	7,357	5,106
	<b>34,119</b>	30,874
Trustee-held debt service reserve fund and acquisition fund—cash and cash equivalents	55,065	67,845
Other trustee-held funds:		
Mutual funds	10,966	9,888
Other assets:		
Cash and cash equivalents	262	3,695
Life insurance contracts	3,185	3,005
Other	1,570	977
	<b>5,017</b>	7,677
	<b>\$206,049</b>	\$188,696

Board-designated funds consist of the Foundation and CAMC's investments for capital and other expenditures. Self-insurance assets are maintained in bank trust accounts. The acquisition project fund was set aside from the proceeds of the 2002 Series A and B Bonds for future capital improvements. Trustee-held investments represent funds set aside for certain Obligated Group debt service requirements (see Note 6). Other assets primarily consist of Foundation trustee-held funds for the Bond Reserve fund and CAMC umbrella trusts assets, both of which are maintained in bank trust departments; also included are the Parent's life insurance contracts.

CAMC Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**5. Investment Income**

Investment income and gains on investments are comprised of the following for the years ended December 31:

	<u>2003</u>	<u>2002</u>
Unrestricted:		
Interest and dividend income	\$ 4,773	\$ 4,731
Realized gains on investments, net	1,491	958
Other-than-temporary losses on investments	-	(3,254)
Net unrealized gains (losses)	<u>18,540</u>	<u>(5,859)</u>
	<b>24,804</b>	<b>(3,424)</b>
Temporarily restricted:		
Interest and dividend income	245	929
Realized gains (losses) on investments, net	307	(837)
Net unrealized gains (losses)	<u>2,914</u>	<u>(4,694)</u>
	<b>3,466</b>	<b>(4,602)</b>
Net investment income and gains and losses	<u>\$ 28,270</u>	<u>\$ (8,026)</u>

The schedule below summarizes the fair value of securities that have gross unrealized losses (the amount by which historical cost exceeds the fair values) as of December 31, 2003. These declines in value are determined to be temporary by the System. The schedule further segregates the securities that have been in a gross unrealized loss position as of December 31, 2003 for less than 12 months and those for 12 months or more. The gross unrealized losses of less than 12 months of \$(635) are a reflection of the normal fluctuations of the stock market and are, therefore, considered temporary. The gross unrealized losses of 12 months or longer of \$(1,711), representing a modest decline in fair value below cost, are reflective of market fluctuations. Based on consultations with its investment advisors, the decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized as of December 31, 2003.

Description of Securities	<u>Less Than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate stocks	\$18,932	\$ (635)	\$10,386	\$(1,711)	\$29,318	\$(2,346)

CAMC Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**6. Long-Term Debt and Operating Lease Obligations**

Obligations under long-term debt is as follows as of December 31:

	2003	2002
2002 Series A and B Bonds	\$ 165,925	\$ 167,550
2000 Series A and B Bonds	17,560	17,775
1995 Series A Bonds	46,685	50,750
Other	12,286	12,262
	242,456	248,337
Less unamortized discount	(696)	(789)
Total long-term debt	241,760	247,548
Less current maturities	(9,622)	(6,388)
	\$ 232,138	\$ 241,160

**2002 Series A and B Bonds and 2000 Series A and B Bonds**

In September 2002, CAMC entered into a loan agreement with the West Virginia Hospital Finance Authority (the Authority) pursuant to which CAMC borrowed the proceeds of the Authority's \$167,550 Variable Rate Revenue Bonds (Charleston Area Medical Center, Inc.), consisting of \$93,075 Variable Rate Revenue Refunding Bonds, 2002 Series A (the 2002 Series A Bonds) and \$74,475 Variable Rate Revenue Bonds, 2002 Series B (the 2002 Series B Bonds) (collectively the 2002 Bonds). The proceeds of the 2002 Series A Bonds were used to advance refund and legally defease \$72,785 of the Authority's \$93,225 Hospital Revenue Bonds (Charleston Area Medical Center, Inc.), 2000 Series A (the 2000 Series A Bonds). The proceeds of the 2002 Series B Bonds were used to pay or reimburse the costs of certain capital expenditures made or to be made by CAMC.

Interest on the 2002 Bonds is variable and accrues at the minimum rate of interest which, in the judgment of the remarketing agent under then-existing market conditions, would result in the sale of the Series 2002 Bonds on such rate determination date at a price equal to the principal amount thereof, plus interest accrued through the rate determination date, which occurs weekly. Interest on the Series 2002 Bonds is payable on the first business day of each month. The Series 2002 Bonds are not supported by a letter of credit, line of credit, standby bond purchase agreement, or any other liquidity facility. As a result, if the remarketing agent cannot successfully remarket

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **6. Long-Term Debt and Operating Lease Obligations (continued)**

optionally or mandatorily tendered 2002 bonds, the bondholders do not have the right to have such non-remarketed bonds purchased by CAMC or any other member of the Obligated Group. The interest accrued on the last rate determination date prior to December 31, 2003 and 2002, was 1.27% and 1.61% for those years, respectively, based upon market conditions that existed at the determination dates.

If any Series 2002 Bond that is part of a series of Series 2002 Bonds in the R-FLOATS Mode is optionally tendered for purchase or is subject to mandatory purchase and either (a) the remarketing agent, after using its reasonable best efforts, is unable to remarket such Series 2002 Bond at the purchase price by 11:00 a.m. New York City time on the purchase date or mandatory purchase date (whether such inability is due to market conditions or otherwise), or (b) such Series 2002 Bond is returned to the holder thereof if the funds available for purchase thereof are inadequate for the purchase of all Series 2002 Bonds so tendered, then from such purchase date or mandatory purchase date until the date on which all Series 2002 Bonds of such series that have been tendered or are subject to mandatory tender are successfully remarketed at the purchase price (the non-remarketing period), all Series 2002 Bonds of such series shall bear interest at a rate per annum equal to the applicable percentage of the BMA Municipal Swap Index, as defined in the bond agreement, in effect during such non-remarketing period.

The 2002 Bonds require principal and interest payments through September 1, 2032.

The 1995, 2000, and 2002 Bonds are secured by promissory notes given to the Authority and issued under the 1993 Restated Master Trust Indenture. The promissory notes are secured by a pledge of revenue and a deed of trust lien on the principal hospital facilities owned by CAMC.

A portion of the 2000 Series A Bonds, in the aggregate principal amount of \$17,755, was not refunded by the 2002 Bonds, and \$17,560 remains outstanding at December 31, 2003. Interest on the 2000 Series A Bonds accrues at rates from 5.3% to 6.75%. The 2000 Series A Bonds require principal and interest payments through September 1, 2030.

On July 1, 2002, substantially all of the assets of Plateau were sold to an unrelated third party. Plateau applied the proceeds of such sale and other available funds, together with operating funds provided by CAMC, to legally defease the Authority's Hospital Revenue Bonds (Oak Hill Hospital, Inc.), 2000 Series B.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **6. Long-Term Debt and Operating Lease Obligations (continued)**

Subsequent to December 31, 2003, CAMC entered into a commitment for a \$16,500 loan draw from the VHA of West Virginia, Capital Asset Financing Program to be repaid over a term of seven years. Monthly installments are required including interest at variable rates. The proceeds will finance the purchase of various equipment and renovations. A note issued under the Obligated Group's Master Trust Indenture will secure the debt.

#### **Derivatives**

In connection with the issuance of the 2002 Bonds, CAMC entered into a floating-to-fixed interest rate swap agreement in the notional amount of \$167,550. The outstanding notional amount as of December 31, 2003 was \$165,925. CAMC pays a fixed rate of 4.18% interest and receives a floating rate of interest equal to the bond rate (Bond Rate), as defined, until September 1, 2012 and will receive the lesser of the BMA Municipal Bond Index rate or the underlying Bond Rate from September 1, 2012 to maturity. Unless terminated, the swap will remain in effect for the life of the 2002 Bonds. The termination date of this agreement is September 1, 2032 and is subject to optional termination by either party on the tenth anniversary of the effective date and each fifth anniversary thereof with a cash settlement. As of December 31, 2003 and 2002, the fair market value of this agreement was \$1,365 and \$(497), respectively, and is included in the balance sheets as a component of accounts payable and other accrued expenses. For the year ended December 31, 2003, the change in market value of this derivative instrument is reflected in the consolidated statement of operations as a component of unrestricted revenue and other support titled derivative (loss) gain. For the year ended December 31, 2002, the derivative instrument qualified as an effective hedge. Accordingly, the change in market value of this derivative for 2002 was reflected in the statement of operations as a component of other changes in unrestricted net assets titled change in derivative hedge valuation.

Also in connection with the issuance of the 2002 Bonds, CAMC entered into a floating-to-floating interest rate swap agreement with a notional amount of \$167,550. The outstanding notional amount as of December 31, 2003 was \$165,925. Pursuant to the agreement, CAMC pays a floating rate of interest equal to the BMA Municipal Bond Index rate and receives the sum of 67% of LIBOR plus 0.55125%. Unless terminated, the swap will remain in effect for the life of the 2002 Bonds. The termination date of this agreement is September 1, 2032 and is subject to optional termination by either party on the tenth anniversary of the effective date and each fifth anniversary thereof with a cash settlement. As of December 31, 2003 and 2002, the fair market

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **6. Long-Term Debt and Operating Lease Obligations (continued)**

value of this agreement was \$(1,948) and \$(3,506), respectively, and is included in the balance sheets as a component of accounts payable and other accrued expenses. The change in market value of this derivative instrument is reflected in the consolidated statements of operations as a component of unrestricted revenue and other support titled derivative (loss) gain.

To evidence its obligations under the swap agreement related to the 2002 Bonds, CAMC issued two promissory notes under its Master Indenture. The first note, CAMC's 2002-4 Note in the nominal principal amount of \$6,700, secures the obligations of CAMC to make regularly scheduled payments to Merrill Lynch Capital Services, Inc. (the Swap Counterparty). The second note, CAMC's 2002-5 Note, is a subordinated note in the nominal principal amount of \$30,000 and secures CAMC's obligation to make a termination payment to the Swap Counterparty under the swap agreement. The 2002-4 Note and the 2002-5 Note were negotiated by CAMC and the Swap Counterparty to give the Swap Counterparty security for CAMC's obligations under the swap agreement. The actual obligation of CAMC on either note may vary significantly from the nominal amounts of each note. Currently, no amounts are outstanding under the 2002-4 Note or the 2002-5 Note.

In connection with the 2002 Bonds, CAMC entered into Debt Service Reserve Forward Delivery Agreements with Wachovia Bank, National Association (Wachovia) and Salomon Brothers Holding Company, Inc. (Salomon Brothers and together with Wachovia, the "Providers"), both dated October 18, 2002 (each a Forward Delivery Agreement and together the "Forward Delivery Agreements"), pursuant to which the Providers will arrange for the investment and reinvestment of an equal portion of the funds held in the Debt Service Reserve Fund created for the 2002 Bonds. Unless terminated, the Forward Delivery Agreements will remain in effect for the life of the 2002 Bonds. If either or both of the Forward Delivery Agreements are terminated, CAMC may be obligated to make termination payments to the Providers. To evidence this contingent obligation under the Forward Delivery Agreement with Wachovia, CAMC issued its 2002-6A Subordinated Note to Wachovia, in the nominal principal amount of \$2,000. To evidence its contingent obligation under the Forward Delivery Agreement with Salomon Brothers, CAMC issued its 2002-6B Subordinated Note, in the nominal principal amount of \$4,000. The actual obligation of CAMC on either note may vary significantly from the nominal amounts of each note. Currently, no amounts are outstanding under the 2002-6A Subordinated Note or the 2002-6B Subordinated Note.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **6. Long-Term Debt and Operating Lease Obligations (continued)**

In conjunction with the 2000 Series A and B Bonds issuance, CAMC entered into a floating-to-floating interest rate swap arrangement with a notional principal amount of \$117,700. As of December 31, 2003 and 2002, the outstanding notional principal amount related to the floating-to-floating swap was \$114,015 and \$115,015, respectively. For this floating-to-floating swap, CAMC pays a floating interest rate on the 2000 notional amount based on the Bond Market Association Municipal Bond Index (which is reset every Wednesday) and receives a floating rate equal to 73.125% of US-LIBOR-BBA on the 2000 notional amount outstanding. The termination date of this agreement is September 1, 2030 and is subject to optional termination by either party on the tenth anniversary of the effective date and each fifth anniversary thereof with a cash settlement. As of December 31, 2003 and 2002, the fair market value of this agreement was \$(4,200) and \$(5,708), respectively, and is included in the balance sheets as a component of accounts payable and other accrued expenses. The change in market value of this derivative instrument is reflected in the consolidated statements of operations as a component of unrestricted revenue and other support titled derivative (loss) gain.

To evidence its obligations under the swap agreement related to the 2000 Bonds, CAMC issued two promissory notes under its Master Indenture. The first note, CAMC's 2000-3 Note in the nominal principal amount of \$3,000, secures the obligations of CAMC to make regularly scheduled payments to the Swap Counterparty. The second note, CAMC's 2000-4 Note, is a subordinated note in the nominal principal amount of \$30,000 and secures CAMC's obligation to make a termination payment to the Swap Counterparty under the swap agreements. The 2000-3 Note and the 2000-4 Note were negotiated by CAMC and the Swap Counterparty to give the Swap Counterparty security for CAMC's obligations under the swap agreements. The actual obligation of CAMC on either note may vary significantly from the nominal amounts of each note. Currently, no amounts are outstanding under the 2000-3 Note or the 2000-4 Note.

In conjunction with the interest rate swap agreements, CAMC also entered into an interest rate cap agreement with a notional amount of \$60,000. Under the agreement, CAMC paid a counterparty \$1,416 in exchange for a promise to be paid the difference between the 7.5% interest rate cap and the reported rate from the BMA Municipal Bond Index to the extent said index exceeds 7.5% applied to the notional amount outstanding. For the years ended December 31, 2003 and 2002, CAMC did not receive a payment under this agreement. The termination date of this agreement is September 12, 2012 with no optional early termination dates. As of December 31, 2003 and 2002, the fair market value of this agreement was \$454 and \$456, respectively, and is included in the balance sheets as a component of accounts payable and other accrued expenses. The change in market value of this derivative instrument is reflected in the consolidated statements of operations as a component of unrestricted revenue and other support titled derivative (loss) gain.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **6. Long-Term Debt and Operating Lease Obligations (continued)**

At December 31, 2003 and 2002, the cumulative net fair value of CAMC's outstanding derivative instruments was a liability of \$4,329 and \$9,254, respectively, and is included in accounts payable and other accrued expenses in the accompanying consolidated balance sheets. During 2003, CAMC recognized a net gain of \$4,925 related to its derivative instruments that did not qualify as hedging instruments. During 2002, CAMC recognized a net loss of \$6,251 related to its derivative instruments that did not qualify as hedging instruments and an additional net loss of \$497 on its qualified hedging instrument. Subsequent to year-end, CAMC's fair value of these derivatives increased to a liability of \$10,175 as of March 31, 2004.

Under the terms of the related derivative contracts, CAMC will maintain collateral posted with the counterparty to secure a portion of the estimated value of the derivative instruments when said instruments are valued in favor of the counterparty, as periodically determined by the counterparty. The minimum amount required in the collateral account regardless of the estimated value of the hedge transactions for 2002 was \$2,400. During 2003, collateral requirements were revised eliminating the minimum collateral requirement and adjusting the collateral limits to begin when aggregate hedge values exceed \$10,000 in favor of the counterparty. The entire collateral account balance from 2002 was refunded to CAMC in 2003. At December 31, 2003 and 2002, CAMC had deposited approximately \$0 and \$2,953, respectively, in collateral with the counterparty, which is reflected in other assets limited as to use in the accompanying consolidated balance sheets.

In February 2004, CAMC executed a swaption with a counterparty for \$3,002 to enter into an interest rate swap agreement on or prior to the first call date (09/01/05) of its 1995 Series A bonds. The option expires September 1, 2005. If the option is exercised, CAMC will enter into an interest rate swap agreement, whereby CAMC will pay a fixed rate of 5.30% on a declining notional amount of \$37,975, and the counterparty will pay a floating rate of 67% of USD-LIBOR-BBA through the termination date of September 1, 2013. The fair market value of this agreement will be included in the balance sheets as a component of accounts payable and other accrued expenses. The change in market value of this derivative instrument will be reflected in the consolidated statements of operations as a component of unrestricted revenue and other support titled derivative (loss) gain. The value of this swaption on March 31, 2004 was a liability of \$3,750.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **6. Long-Term Debt and Operating Lease Obligations (continued)**

To evidence its obligations under the swaption agreement, CAMC issued two promissory notes under its Master Indenture. The first note, CAMC's 2004-A Note, secures the obligations of CAMC to make regularly scheduled payments to the Swap Counterparty. The second note, CAMC's 2004-A Subordinated Note, is a subordinated note that secures CAMC's obligation to make payments other than the regularly scheduled payments to the Swap Counterparty under the swaption agreement. The nominal principal amounts of the notes have not yet been determined. The actual obligation of CAMC on either note may vary significantly from the nominal amounts of each note.

#### **1995 Series A Bonds**

In 1995, CAMC entered into a refinancing agreement with the Authority relating to the refunding of the 1986 Series A, 1989 Series A and 1989 Series B Hospital Revenue Refunding Bonds. In connection with this agreement, the Authority issued the 1995 Series A Hospital Revenue Refunding Bonds in the aggregate principal amount of \$73,420. Interest on the bonds accrues at rates ranging from 4.5% to 5.75%. The bonds mature on various dates through 2006 and on September 1, 2013. The bonds maturing on September 1, 2013 are subject to mandatory redemption prior to maturity commencing September 1, 2007. The bonds are secured by a promissory note, 1995 Series A Note, given to the Authority as specified under CAMC's 1993 Restated Master Trust Indenture (the Master Trust Indenture).

#### **Other**

In May 2001, Braxton entered into a loan agreement with the West Virginia Hospital Association pursuant to which Braxton borrowed \$1,970 West Virginia Hospital Finance Authority Variable Rate Demand Revenue Bonds, 2001 Series B-2. The proceeds of the 2001 Series B-2 Bonds were used to fund capital expenditures. Interest on the 2001 Series B-2 Bonds accrues interest at variable rates presently at 1.34% at December 31, 2003. The 2001 Series B-2 Bonds require principal and interest payments of approximately \$37 annually through May 2011.

The Women and Children's Medical Office Building Partnership, which is included in CAMC's accounts, had a promissory note payable to a financial institution for \$4,883, which would have matured on December 31, 2004. The average interest rate on the note was 2.74% and 3.27% in 2003 and 2002, respectively. Payments were made totaling \$1,683 during 2003. On December 31, 2003 the balance of \$3,200 was refinanced through Bank One at the annual rate of 2.43%. The loan is secured by the building and guaranteed by CAMC.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **6. Long-Term Debt and Operating Lease Obligations (continued)**

The West Virginia Hospital Finance Authority Hospital Refunding Revenue Bonds 1992 Series A, dated October 1, 1993, were issued for \$4,770 on behalf of the General Division Medical Office Building Partnership. The bonds bear interest at a rate that fluctuates so as to remain equal to the prime rate, as defined, effectively 4.0% and 4.25% at December 31, 2003 and 2002, respectively. The bonds are secured by the office building and guaranteed by CAMC.

#### **Obligated Group**

The Foundation and CAMC are members of the Obligated Group, in accordance with the provisions of the Master Trust Indenture and are jointly and severally liable for the performance of all covenants and obligations contained in the Master Trust Indenture and in the related notes and guarantees. The 1995 Series A Bonds and 2000 Series A Bonds, 2002 Series A and B Bonds and various notes, lines and letters of credit are obligations under the Master Trust Indenture. Foundation unrestricted net assets in the amount of \$93,750 and \$78,433 are available at December 31, 2003 and 2002, respectively, to satisfy obligations of the Obligated Group.

#### **Debt Covenants**

In connection with the long-term obligations detailed above, members of the Obligated Group (CAMC and the Foundation) are subject to certain restrictive covenants which require, among other items, the Obligated Group to maintain certain financial ratios as defined in the debt agreements and make certain informational filings with its creditors.

CAMC Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**6. Long-Term Debt and Operating Lease Obligations (continued)**

**Debt Service Requirements**

The System is required to make the following principal and interest payments under long-term debt obligations as of December 31, 2003:

	<u>Bond Series</u>				<u>Total</u>
	<u>1995A</u>	<u>2000A</u>	<u>2002A and 2002B</u>	<u>Other</u>	
2004	\$ 6,766	\$ 1,380	\$ 8,615	\$ 4,091	\$ 20,852
2005	6,763	1,377	8,595	1,003	17,738
2006	6,759	1,377	8,598	1,016	17,750
2007	6,735	1,378	8,597	1,024	17,734
2008	6,727	1,379	8,594	1,030	17,730
Thereafter	26,627	32,263	258,101	4,122	321,113
Total payments	60,377	39,154	301,100	12,286	412,917
Amounts representing interest and unamortized discount	(14,223)	(21,760)	(135,174)	-	(171,157)
Present value of future minimum payments	\$ 46,154	\$ 17,394	\$165,926	\$ 12,286	\$241,760
Market value at December 31, 2003	\$ 50,106	\$ 19,514	\$167,550		

**Operating Lease Agreements**

The System leases various land, computer, office and movable equipment under noncancelable operating lease agreements expiring at various dates through 2013. The following payments are required under the noncancelable operating lease agreements as of December 31, 2003:

2004	\$ 3,695
2005	3,201
2006	2,590
2007	1,869
2008	1,503
Thereafter	3,825
	<u>\$ 16,683</u>

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **6. Long-Term Debt and Operating Lease Obligations (continued)**

Total expense for operating leases, which is included in supplies and other in the accompanying consolidated statements of operations, was \$4,156 and \$3,550 for the years ended December 31, 2003 and 2002, respectively.

#### **7. Lines of Credit and Short-Term Borrowings**

For 2002 and prior to November 20, 2003, CAMC had a revolving line of credit for \$8,000 including an allocation of an additional \$1,998 to a letter of credit for the benefit of Braxton as a credit enhancement for the Series 2001 B-2 Bonds borrowed by Braxton. This line of credit was to expire on October 1, 2004, with the letter of credit automatically renewing for periods of one year until October 1, 2010. On July 24, 2002, CAMC executed a commitment letter with a bank for a second revolving line of credit in the aggregate amount of \$5,000. This second line of credit also expires on October 1, 2004.

On April 7, 2003 CAMC paid the \$8M and \$5M revolving lines of credit in full. These two lines of credit remained open until a new line of credit was established on November 20, 2003 in the amount of \$10M available for short-term working capital needs. This line of credit expires October 1, 2006. As of December 31, 2003, no amount was outstanding on this line of credit. Draws on the line of credit have a variable rate interest charge based on 30-day LIBOR rate plus a margin.

During 2003, CAMC also renewed the letter of credit for the benefit of Braxton in the amount of \$1,660. This letter of credit serves as a credit enhancement for the Series 2001 B-2 bonds borrowed by Braxton. The letter of credit is automatically annually renewable until October 1, 2010. The letter of credit for Braxton remains unencumbered. As of December 31, 2003, there was \$6,254 committed to an undrawn workers' compensation letter of credit.

All of the above described lines of credit are supported by notes issued under the Master Trust Indenture and secured by a pledge of revenues and a deed of trust lien on the principal hospital facilities owned by CAMC.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **8. Liabilities for Self-Insurance Reserves**

Certain System subsidiaries are self-insured for professional malpractice and general liability claims through the CAMCHSI and Affiliates Malpractice Self-Insurance Trust (the Trust). Participating affiliates have proportionate rights to the Trust account balances held under the custodial management of a bank trust department and can withdraw from the Trust subject to certain actuarially determined thresholds. The Trust accounts are used for payment of any professional malpractice and general liability losses, expenses relating thereto, costs of administering the Trust, and insurance premiums for coverage in excess of the self-insured limits.

Contributions to the Trust are made as determined using statistical analysis by an independent actuarial valuation of occurrence-based risks, which includes consideration of incurred but not reported claims exposure. The System's methodology for estimating this self-insured obligation is a simulation modeling approach largely dependent on the System's actual loss history. As of December 31, 2003 and 2002, the System has recorded approximately \$24,800 and \$26,300, respectively, as the liability for self-insured asserted and unasserted professional malpractice and general liability claims. The estimated current portion of \$8,736 in 2003 and \$5,381 in 2002 is included in accounts payable and accrued expenses in the accompanying balance sheets. The estimated liability for such malpractice and general liability claims has been discounted using a discount rate of 5% in both 2003 and 2002. While the ultimate amount of costs incurred under the System's self-insured programs is dependent on future developments, in management's opinion, recorded reserves are adequate to cover the future settlement of claims. However, it is reasonably possible that recorded reserves may not be adequate to cover the future settlement of claims. Adjustments, if any, to estimates recorded resulting from ultimate claim payments will be reflected in operations in the periods in which such adjustments are known.

The malpractice self-insurance limits are a maximum \$3,000 per occurrence and a maximum annual aggregate limit of \$12,000 for May 1, 2001 through April 30, 2002, \$5,000 per occurrence and a maximum annual aggregate limit of \$20,000 for May 1, 2002 through April 30, 2003, and \$7,000 per occurrence and a maximum annual aggregate limit of \$25,000 after May 1, 2003.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 8. Liabilities for Self-Insurance Reserves (continued)

Certain System subsidiaries are also self-insured for workers' compensation, unemployment compensation, and disability. The workers' compensation plan's trust fund is under the custodial management of a bank trust department. The obligation is recorded in accounts payable and accrued expenses and self-insurance reserves in the accompanying balance sheets for these programs is \$6,170 and \$5,161 at December 31, 2003 and 2002, respectively, and is estimated using statistical analyses by consulting actuaries.

#### 9. Benefit Plans

##### Retirement Savings Plan

All employees of participating employers (CAMC, Braxton, the Institute and the Foundation) are eligible to participate in a retirement savings plan. Employees may contribute from 1% to 19% of their salary, subject to certain limitations, to the plan and the employers will match from 1% to 6% based on the employees' years of service. Total employer contributions to the retirement savings plan were \$5,972 and \$5,776 during 2003 and 2002, respectively, which is included in employee benefits in the accompanying consolidated statements of operations.

##### Postretirement Benefits Other Than Pensions

Effective May 1, 1998, employees were notified of the discontinuation of postretirement health benefits. In accordance with SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, as of the effective date, CAMC ceased recognizing service costs related to the health care component of the benefit. However, life insurance and sick day buyout benefits remain. Postretirement benefits information is summarized below.

	<b>December 31</b>	
	<b>2003</b>	<b>2002</b>
Benefit obligation	<b>\$ 13,164</b>	\$ 23,868
Underfunded status	<b>13,164</b>	23,868
Employer contributions	<b>993</b>	1,243
Participant contributions	<b>870</b>	639
Benefits paid	<b>1,863</b>	1,243

CAMC Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Benefit Plans (continued)**

The 2003 and 2002 postretirement benefit expense for the years ended December 31 was as follows:

	<u>2003</u>	<u>2002</u>
Service cost of benefits earned	\$ 20	\$ 34
Interest cost on accumulated postretirement benefit obligation	1,538	1,244
Amortization:		
Transition obligation	1	1
Actuarial (gain) loss	(144)	65
Net periodic postretirement expense, included in employee benefits expense	<u>\$ 1,415</u>	<u>\$ 1,344</u>

The postretirement benefit plan is not funded. Expected contributions to be paid in 2004 are \$1,348. Information related to the amounts recognized in the balance sheets as of December 31 is as follows:

	<u>2003</u>	<u>2002</u>
Underfunded status at end of year	\$ 13,164	\$ 23,868
Unrecognized net transition obligation	(2)	(4)
Unrecognized prior service credit (plan amendments)	11,523	-
Unrecognized net actuarial loss	(6,574)	(5,489)
Accrued postretirement benefit obligations	<u>\$ 18,111</u>	<u>\$ 18,375</u>

The estimated current portion of the obligation of approximately of \$1,344 in 2003 and \$1,347 in 2002 is included in accounts payable and accrued expenses in the accompanying balance sheets. For measurement purposes, an annual rate of increase in the per capita cost of covered health care benefits of 10%, declining to 5%, was assumed for 2004 and thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the postretirement benefit obligation for 2003 by \$863. A discount rate of 6.25% and 6.75% was used to determine the postretirement benefit obligation as of December 31, 2003 and 2002, respectively.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **9. Benefit Plans (continued)**

Certain plan amendment changes were recognized in the 2003 valuation based on changes that have been committed to by management and communicated to the retirees. First, the retiree contributions for the medical plan were increased from 25% to 75% in 2004, and the retiree contributions for the drug plan were increased from 25% to 60% in 2004. Second, the life insurance plan was amended to remove coverage for future retirees.

CAMC has elected to defer the accounting and disclosure requirements as provided by Financial Staff Position No. FAS 106-1, which addresses the accounting and disclosure implications arising as a result of the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act). Accordingly, the measures of the postretirement benefit obligation and net periodic postretirement benefit costs in the consolidated financial statements and accompanying notes do not reflect the effects of the Act on the plan. Specific authoritative guidance on the accounting for the federal subsidy is pending, and that guidance, when issued, could require the sponsor to change previously reported information.

#### **10. Related Party Transactions**

West Virginia University (WVU) employs physicians who provide medical education and supervision to the resident physicians employed by CAMC. In 2003 and 2002, CAMC provided \$4,904 and \$3,695, respectively, to WVU for the physicians who teach and supervise the resident physicians. The fee paid to WVU is included in supplies and other expense in the accompanying consolidated statements of operations. CAMC has committed \$6,155 to further support WVU during 2004 for the use of the teaching and supervising physicians.

CAMC, Cabell Huntington Hospital, and West Virginia University Hospital are members of HealthNet, Inc. (HNET). Each member's legally controlled percentage is 33 1/3%. HNET is a West Virginia nonprofit corporation, which the Internal Revenue Service has determined is recognized as exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. HNET is an aeromedical transport service company. Members are required to support HNET to the extent that expenses exceed revenues. For the years ended December 31, 2003 and 2002, HNET revenues exceeded expenses by \$602 and \$616, respectively. The excess is distributed to the members during the following fiscal year. HNET also reimburses CAMC for operating expenses incurred on its behalf, as well as for certain financial services. HNET reimbursed CAMC approximately \$2,300 in 2003 and \$2,500 in 2002 for such services.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 11. Functional Expenses

The functional expenses related to the System's operations are as follows:

	<u>2003</u>	<u>2002</u>
Provision of health care and related services	\$ 430,704	\$ 407,287
General and administrative	131,076	156,049
	<u>\$ 561,780</u>	<u>\$ 563,336</u>

#### 12. Commitments and Contingencies

##### Litigation

Companies of the System are party to several routine lawsuits incidental to their operations. It is not possible at the present time to estimate the ultimate legal and financial liability, if any, with respect to certain lawsuits. In the opinion of management, after consultation with counsel, adequate insurance exists in the event of any significant financial exposure. Accordingly, in the opinion of management, resolution of those matters is not expected to have a material adverse effect on the System's consolidated financial position or results of its operations. However, depending on the amount and timing of such resolution, an unfavorable resolution of some or all of these matters could materially affect the future results of operations or cash flows in a particular period.

##### Rate Regulation

The Health Care Authority (HCA) is empowered, by provisions of the West Virginia Code, to regulate CAMC's gross patient revenues from nongovernment payors and to evaluate health care entity financial performance. This is accomplished by issuing rate orders, based on CAMC's budgets and rate schedules, and evaluating performance and compliance reports submitted by CAMC on a periodic basis. Addition and deletion of services is also regulated by HCA.

In prior years, HCA levied penalties against CAMC. These penalties may be reduced based on an annual plan that CAMC submits to the Authority outlining community service projects. The plan may contain community services that are already being provided on a regular basis, but must also include new community service projects. CAMC must submit such plan to the Authority outlining the community services to be provided in future years along with the amount of the

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **12. Commitments and Contingencies (continued)**

penalty that CAMC believes should be eliminated as a result of each service. On October 15, 2003, CAMC received an order from the Authority eliminating its remaining penalties of \$9,650 based on CAMC's community service report filed with the Authority on August 30, 2003.

#### **Regulatory Matters**

CAMC was served with an administrative subpoena issued by the United States Attorney for the Southern District of West Virginia in November 2002, related to billings for Medicaid and Medicare therapy services provided by CAMC from 1999 to 2001.

In December 2003, CAMC executed a settlement agreement with the U.S. Department of Health and Human Services, Office of the Inspector General (OIG) related to billings for Medicaid and Medicare therapy services provided by CAMC from 1999 to 2001. The settlement, including a payment of \$1.3 million in December 2003, was agreed upon in order to avoid the possible delay and expense that would be involved in litigating claims made by the OIG that CAMC submitted certain inappropriate billings to the Medicare and Medicaid programs. No admission of wrongdoing by CAMC was made through this agreement. The provisions of this agreement apply to CAMC only, not the Parent or any of its other subsidiaries. As part of the settlement, CAMC agreed to comply with the terms of a Corporate Integrity Agreement (CIA) for a five-year period from the effective date. The CIA requires that CAMC maintain its existing compliance program and that it expand the following areas of compliance activity: training of employees, selected physicians, and selected contractors; updating and adding to the existing compliance policies and procedures; reporting of overpayments to the OIG; screening employees and others against the exclusion lists maintained by the OIG and the federal General Services Administration; providing periodic reports to the OIG; and retaining an independent review organization to monitor compliance with the CIA. CAMC is working toward the completion of all requirements of the CIA and expects that compliance will be achieved.

The System has received notification that certain government agencies are reviewing billings for certain types of services rendered. System management is of the opinion that the effect of these reviews will not be material to the financial position or results of operations of the System. However, the System has not quantified and is unable to quantify the amounts, if any, that it may need to repay by reason of unnecessary services being ordered, furnished, and billed or services being billed incorrectly, and no amount has been specified by the government agencies.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **12. Commitments and Contingencies (continued)**

##### **IT Outsourcing**

In August 2003, CAMC entered into a ten-year agreement with Siemens Medical Solutions USA, Inc. (Siemens) for the license, implementation, and support of the software for its core information services applications, with CAMC's total commitment related to this agreement, \$41,031, to be paid in 120 monthly installments of \$342 plus applicable sales tax and subject to an annual adjustment as described in the agreement during the ten-year term. This commitment is allocated between license fees of \$10,523, implementation fees of \$8,052, and support fees of \$22,456.

Further, CAMC entered into an information technology (IT) outsourcing agreement with Siemens concurrently with the execution of the license, implementation and support agreement. Under the outsourcing agreement, CAMC outsourced to Siemens the services previously provided by its employees, including maintaining software and hardware and providing information systems and telecommunications services to CAMC and its affiliates. Under the agreement, most all CAMC employees providing the outsourced services were offered employment by Siemens at or above compensation levels paid by CAMC and were guaranteed employment, except for cause, for 12 months after signing of the agreement. The term of the outsource agreement is ten years and may be terminated by CAMC with 30 days' notice if Siemens fails to meet or exceed Service Level Standards as defined in the agreement. Siemens may terminate the agreement under certain defined conditions with notice that varies by condition. Upon the termination of this agreement for any reason, CAMC has the option but not the obligation to hire any of Siemens' staff assigned to CAMC operations with the exception of the site manager. CAMC will pay salaries and benefits for the Siemens employees working at CAMC during the duration of the agreement. Annual expenditures related to this outsourcing agreement are expected to approximate \$7,200 annually over the life of the agreement, subject to an annual adjustment as described in the agreement during the ten years.

Total fees incurred during the year ended December 31, 2003 related to all of these agreements were \$5,917. Of this amount, \$1,972 was capitalized related to the development of internal use software.

## CAMC Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **13. Fair Value of Financial Instruments**

The following methods and assumptions were used by the System in estimating the fair value of its financial instruments:

##### *Cash, Cash Equivalents and Short-Term Investments*

The carrying amount reported in the balance sheets for cash, cash equivalents, and short-term investments approximates its fair value.

##### *Assets Limited as to Use*

The fair value for assets limited as to use is based on quoted market prices, if available, or estimated using quoted market prices for similar securities (see Note 4).

##### *Long-Term Debt*

The market values of long-term debt obligations under the 1995 Series A Bonds, the 2000 Series A and B Bonds, and the 2002 Series A and B Bonds were determined by CAMC's underwriters. Since bid and offer prices are not readily available for these debt obligations, these estimated values were based on market values of similar financial instruments. The assigned value of the obligations is the lesser of the price to maturity or the price to the first call date.

Because the System's credit standing has not changed significantly since the issuance of its variable rate debt in 2003, management believes the carrying value of variable rate debt at December 31, 2003 approximates its fair value (see Note 6).