



SAINT MARY'S HEALTH SYSTEM, INC.

Consolidated Financial Statements and
Consolidating Information

September 30, 2009 and 2008

(With Independent Auditors' Report Thereon)

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidated Financial Statements and
Consolidating Information

September 30, 2009 and 2008

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KPMG LLP
One Financial Plaza
Hartford, CT 06103-4103

Independent Auditors' Report

The Board of Directors
Saint Mary's Health System, Inc.:

We have audited the accompanying consolidated balance sheets of Saint Mary's Health System, Inc. (the System) as of September 30, 2009 and 2008, and the related statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 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 System'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 financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Saint Mary's Health System, Inc. as of September 30, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information as of and for the year ended September 30, 2009 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual companies. The consolidating information has been subjected to the auditing procedures applied in the audit of the 2009 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2009 consolidated financial statements taken as a whole.

KPMG LLP

February 5, 2010

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidated Balance Sheets

September 30, 2009 and 2008

(In thousands)

Assets	2009	2008
Current assets:		
Cash and cash equivalents	\$ 23,213	17,469
Short-term investments	1,082	1,078
Current portion of assets whose use is limited	4,739	3,582
Accounts receivable, net of estimated uncollectibles of \$7486 in 2009 and \$6,178 in 2008	25,784	23,771
Other current assets	3,966	5,586
Total current assets	58,784	51,486
Marketable securities	14,032	13,567
Assets whose use is limited:		
By donor and held in trust by others	12,785	13,048
For estimated self-insurance liability	25,793	24,153
By bond indenture	5,873	5,066
Other	6	6
Total assets whose use is limited	44,457	42,273
Less current portion of assets whose use is limited	4,739	3,582
Noncurrent assets whose use is limited	39,718	38,691
Property and equipment, net	55,753	56,615
Other assets:		
Investments in joint venture arrangements	8,614	7,701
Deferred financing costs, net	250	291
Other noncurrent assets	682	1,196
Total other assets	9,546	9,188
Total assets	\$ 177,833	169,547
Liabilities and Net Assets		
Current liabilities:		
Current portion of long-term obligations	\$ 2,736	2,958
Accounts payable	11,432	14,441
Salaries, wages, and payroll withholdings	7,104	6,086
Due to third-party payors, net	6,847	5,428
Accrued expenses and other current liabilities	8,605	7,605
Total current liabilities	36,724	36,518
Long-term liabilities:		
Long-term obligations, net of current portion	28,263	30,566
Estimated self-insurance liability	16,848	16,550
Pension and deferred compensation	71,557	59,737
Other long-term liabilities	9,443	6,865
Total long-term liabilities	126,111	113,718
Minority interest in subsidiaries	1,855	2,064
Net assets (deficit):		
Unrestricted	(3,025)	854
Temporarily restricted	2,387	2,352
Permanently restricted	13,781	14,041
Total net assets	13,143	17,247
Total liabilities and net assets	\$ 177,833	169,547

See accompanying notes to consolidated financial statements.

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidated Statements of Operations

Years ended September 30, 2009 and 2008

(In thousands)

	<u>2009</u>	<u>2008</u>
Revenues:		
Net revenue from patient services	\$ 238,143	228,309
Other operating revenues	7,585	6,843
Total revenues	<u>245,728</u>	<u>235,152</u>
Expenses:		
Salaries and wages	102,507	102,567
Employee benefits	27,782	26,702
Supplies and other expenses	83,457	79,995
Provision for uncollectible accounts, net of recoveries	13,161	11,890
Depreciation and amortization	8,750	9,132
Interest	1,903	2,060
Total expenses	<u>237,560</u>	<u>232,346</u>
Operating income	<u>8,168</u>	<u>2,806</u>
Nonoperating gains (losses):		
Investment losses, net	(1,271)	(1,008)
Equity in earnings of joint ventures	2,051	2,516
Minority interest in subsidiaries	(1,043)	(888)
Net (loss) gain on disposal of assets	(91)	414
Other	639	411
Total nonoperating gains, net	<u>285</u>	<u>1,445</u>
Excess revenues over expenses	<u>8,453</u>	<u>4,251</u>
Net assets released from restriction for capital expenditures	150	1,487
Change in unrealized gains (losses) on marketable securities and other assets whose use is limited	638	(2,010)
Change in accumulated pension charges to unrestricted net assets	<u>(13,120)</u>	<u>(3,972)</u>
Decrease in unrestricted net assets	\$ <u><u>(3,879)</u></u>	<u><u>(244)</u></u>

See accompanying notes to consolidated financial statements.

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidated Statements of Changes in Net Assets

Years ended September 30, 2009 and 2008

(In thousands)

	<u>2009</u>	<u>2008</u>
Unrestricted net assets:		
Excess of revenues over expenses	\$ 8,453	4,251
Net assets released from restriction for capital expenditures	150	1,487
Capital transactions with affiliates	—	—
Change in unrealized gains on marketable securities and other assets whose use is limited	638	(2,010)
Change in accumulated pension charges to unrestricted net assets	(13,120)	(3,972)
Cumulative effect of change in accounting principle	—	(91)
	<u>(3,879)</u>	<u>(335)</u>
Decrease in unrestricted net assets		
Temporarily restricted net assets:		
Net assets released from restriction	(286)	(1,477)
Restricted contributions	504	843
Change in net assets of Cancer Center, including releases for capital expenditures	(183)	(135)
Cumulative effect of change in accounting principle	—	91
	<u>35</u>	<u>(678)</u>
Increase (decrease) in temporarily restricted net assets		
Permanently restricted net assets:		
Decrease to assets held in trust by others	(260)	(2,961)
	<u>(260)</u>	<u>(2,961)</u>
Decrease in permanently restricted net assets		
Decrease in net assets	(4,104)	(3,974)
Net assets – beginning of year	<u>17,247</u>	<u>21,221</u>
Net assets – end of year	\$ <u>13,143</u>	<u>17,247</u>

See accompanying notes to consolidated financial statements.

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidated Statements of Cash Flows

Years ended September 30, 2009 and 2008

(In thousands)

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Decrease in net assets	\$ (4,104)	(3,974)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Depreciation and amortization	8,750	9,132
Net loss (gain) on disposal of assets	91	(414)
Change in unrealized (gains) losses on investments	(638)	2,010
Change in net assets of Cancer Center	183	135
Change in accumulated pension charges to unrestricted net assets	13,120	3,972
Investment losses, net	1,271	1,008
Equity in earnings of joint ventures and partnerships	(2,051)	(2,516)
(Increase) decrease in operating assets:		
Accounts receivable, net	(2,013)	(256)
Other current assets	1,620	(1,363)
Other non current assets	514	1,408
Increase (decrease) in operating liabilities:		
Due to third-party payors, net	1,419	1,249
Accounts payable and other current liabilities	(991)	1,158
Estimated self-insurance liability	298	(1,093)
Minority interest in subsidiaries	(209)	(11)
Pension, accrued compensation, and other long term liabilities	1,278	2,962
Net cash provided by operating activities	<u>18,538</u>	<u>13,407</u>
Cash flows from investing activities:		
Purchases of property and equipment	(7,938)	(7,608)
Distributions from joint ventures and partnerships	1,072	1,312
Investments in joint venture arrangements	(117)	175
Change in other assets whose use is limited	(1,377)	6,144
Net increase in investments	<u>(1,102)</u>	<u>(2,374)</u>
Net cash used in investing activities	<u>(9,462)</u>	<u>(2,351)</u>
Cash flows from financing activities:		
Increase in assets whose use is limited by bond indentures	(807)	(89)
Borrowings under long-term obligations	494	—
Payments on long-term obligations	<u>(3,019)</u>	<u>(3,318)</u>
Net cash used in financing activities	<u>(3,332)</u>	<u>(3,407)</u>
Net increase in cash and cash equivalents	5,744	7,649
Cash and cash equivalents – beginning of year	<u>17,469</u>	<u>9,820</u>
Cash and cash equivalents – end of year	\$ <u><u>23,213</u></u>	\$ <u><u>17,469</u></u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	\$ 1,885	2,037

See accompanying notes to consolidated financial statements.

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(1) Organization

Saint Mary's Health System, Inc. (SMHS or the System) is a not-for-profit, nonstock Connecticut holding company. It is the sole member of Saint Mary's Hospital, Inc. (the Hospital), Saint Mary's Hospital Foundation, Inc. (the Foundation), and Saint Mary's PHO, Inc. (the PHO).

The Hospital is an acute care hospital located in Waterbury, Connecticut. The Hospital was founded in 1907 and is licensed for 347 beds and 32 newborn bassinets. The Hospital currently staffs 175 beds and 20 newborn bassinets. The Hospital provides a broad range of inpatient and outpatient services including a number of medical and surgical specialties, obstetrics, pediatrics, mental health, alcohol and substance abuse rehabilitation (outpatient) and off-site ambulatory services.

The Hospital has six consolidated subsidiaries: Franklin Medical Group, P.C. (Franklin), a for-profit Connecticut corporation; Scovill Medical Group, P.C. (Scovill), a for-profit Connecticut corporation; Primary Care Partners, P.C. (Partners), a for-profit Connecticut corporation; Saint Mary's Indemnity Company, LLC (the Indemnity Company) a Vermont limited liability company; Naugatuck Valley Surgical Center, LP (the Surgical Center), a Connecticut limited partnership and Diagnostic Imaging of Southbury, LLC (the Diagnostic Center), a for-profit Connecticut corporation.

Scovill owns and operates physician practices in the greater Waterbury area. Franklin, consisting of certain Hospital based physicians, provides mainly outpatient services. Partners was formed during December 2008 to own and operate additional physician practices.

The Indemnity Company was formed during June 2009 to provide professional and general liability insurance to the Hospital, Franklin, Scovill, Partners, and community physicians.

The Hospital has approximately an 85% equity interest in the Surgical Center, which provides ambulatory surgery services. The Hospital acquired this controlling interest in the Surgical Center during fiscal year 2001. The remaining 15% interest is accounted for as a minority interest in the accompanying consolidated financial statements.

The Hospital has a 60% equity interest in the Diagnostic Center, which provides diagnostic imaging services. The remaining 40% interest is accounted for as a minority interest in the accompanying consolidated financial statements.

The Foundation was organized to raise funds to support the Hospital.

The PHO was dissolved during July 2009. The net assets of the organization were transferred to the System.

The assets, liabilities and operations of the Hospital's Auxiliary have not been reflected in the accompanying consolidated financial statements. Such amounts are not considered significant to the Hospital's consolidated financial position or results of its operations.

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

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(2) Community Benefit (Unaudited)

The Hospital is a community teaching hospital that serves the healthcare needs of the Central Naugatuck Valley area. Like other healthcare providers across the nation, the Hospital is faced with the challenge of serving those in need with fewer resources. Although the Hospital cannot meet community needs alone, it is committed to seek out unmet community needs and to be a catalyst in efforts to ensure an adequate community-wide response from government and public organizations in fulfilling community needs.

(a) *Charity and Uncompensated Care*

As part of fulfilling its mission, the Hospital provides care to all patients in need, regardless of their ability to pay. The Hospital has a formalized charity care policy that identifies which patients are deemed "charity care". During 2009 and 2008, charges foregone related to charity care were approximately \$493,000 and \$584,000 respectively. Management is currently reviewing and updating the Hospital's charity care policies and processes as it believes \$5,376,000 and \$5,099,000 of charges in 2009 and 2008, respectively, are classified as bad debt due to patients' unwillingness to complete documentation necessary to be deemed charity care.

In addition, the Hospital provides care to patients covered by governmental healthcare programs. During 2009 and 2008, the Hospital estimates that the cost of providing this care exceeded compensation by \$7,845,000 and \$8,055,000, respectively.

(b) *Education, Research and Training*

As a community teaching hospital affiliated with Yale School of Medicine, the Hospital has residency programs for general surgery, internal medicine and dental. These programs educate in excess of 50 residents and medical students per year. In addition to its residency programs, the Hospital furthers its educational mission by offering allied health programs affiliated with area educational facilities.

(c) *Wellness and Health Promotional Activities*

The Hospital provides many activities to promote the concept of healthy lifestyles, including the publishing and free distribution of *Discover*, which reaches more than 70,000 community households, health risk screenings, health fairs, support groups, speakers bureau and free telephone physician referral services through the Physician Referral program.

(d) *Leadership, Advocacy and Voluntarism*

The Hospital's employees are responsive to the community in the areas of planning, governance and service by annually providing thousands of hours of volunteer services, participating on boards of directors and advisory councils, testifying before public policy bodies and working with other healthcare organizations to develop healthcare policies for all persons. The Hospital also provides volunteer opportunities for community residents. The Hospital recognizes donated goods and services at their appraised or estimated value if they create or enhance nonfinancial assets or require specialized skills and would typically be purchased if not provided by donation. The volunteer services the Hospital received do not meet this criteria for recognition in the accompanying

SAINT MARY'S HEALTH SYSTEM, INC.

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consolidated financial statements, but the volunteers donate a significant amount of time to the Hospital. In fiscal years 2009 and 2008, over 120 volunteers per year spent more than 14,000 hours and 17,000 hours, respectively, of service in Hospital departments.

(e) *Dollar, Time and In-kind Donations*

The Hospital also provides services to neighborhood schools and organizations at no cost. Contributions are made to programs, organizations and foundations for efforts on behalf of the poor, the disadvantaged and the general population. The Hospital also provides a variety of in-kind services including education on parenting and child abuse prevention and use of Hospital space for community meetings.

(f) *Other Support Services*

The Hospital provides outreach and social support services to patients. Programs such as the Sleep Disorders Support Group and the Chronic Lung Disorders/Pulmonary Support Group are integral to the healing of patients, and represent the Hospital's overall commitment to the continuum of care.

(3) Summary of Significant Accounting Policies

(a) *Basis of Presentation*

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles. All intercompany transactions have been eliminated in consolidation.

(b) *New Accounting Pronouncements*

Effective October 1, 2007, the System adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109* (FIN 48) now part of FASB ASC 740, Income Taxes. FIN 48 clarifies the accounting for uncertainty in income tax recognized in an entity's financial statements. FIN 48 requires entities to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement, and classification of income tax uncertainties, along with any related interest or penalties. A tax position is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon settlement. The adoption of FIN 48 had no impact on the System's consolidated financial statements.

Effective October 1, 2008 the System adopted Statement 157, *Fair Value Measurement* (Statement 157), now part of FASB ASC 820. Statement 157 defines fair value, establishes a framework for the measurement of fair value, and enhance disclosures about fair value measurement. The Statement does not require any new fair value measures. The Statement is effective for fair value measures already required or permitted by other standards for fiscal years beginning after November 15, 2007. Statement 157 is required to be applied prospectively, except for certain financial instruments. Any

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transition adjustment will be recognized as an adjustment to opening net assets in the year of adoption. The adoption had no impact on the System's results of operations and financial position.

In May 2009, the FASB issued guidance which established principles and requirements for recognition and disclosure of subsequent events. In particular, it sets forth the period after the balance sheet date during which management of a reporting entity shall evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that an entity shall make about events or transactions that occurred after the balance sheet date. This guidance is to be applied to the accounting for and disclosure of subsequent events not addressed in other applicable GAAP and was effective for the year ended September 30, 2009. In accordance with the guidance, management has evaluated events subsequent to September 30, 2009 and through February 5, 2010, the date on which the consolidated financial statements were issued. The adoption of these principles and requirements did not have an impact on the System's financial statements.

(c) *Net Patient Service Revenue*

The System has agreements with third-party payors that provide for payments to the System 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.

(d) *Charity Care and Provision for Uncollectible Accounts*

The System provides care to patients who meet certain criteria under its financial assistance policy without charge or at amounts less than their established rates. Because the System does not anticipate collection of amounts determined to qualify as charity care, they are not reported as revenue.

The System grants credit without collateral to patients, most of whom are local residents and are insured under third-party arrangements. Additions to the allowance for uncollectible accounts are made by means of the provision for uncollectible accounts. Accounts written off as uncollectible are deducted from the allowance and subsequent recoveries are added. The amount of the provision for uncollectible accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental health care coverage and other collection indicators.

(e) *Cash and Cash Equivalents*

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

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The System invests its surplus operating funds in overnight repurchase agreement investments. These investments are collateralized with securities issued by the United States Government or its agencies and are not covered by FDIC insurance.

(f) *Assets Limited as to Use*

Assets limited as to use primarily include assets held by others pursuant to donor restrictions, by trustees under indenture agreements, and by a captive insurance company for professional and general liability insurance.

(g) *Marketable Securities*

Investments in equity securities, mutual funds and all investments in debt securities are reported at fair value based on readily determinable fair market values or estimated fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized 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. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities or are considered to be other than temporarily impaired.

In light of the market conditions over the past year, the System has reviewed its investments in order to determine if any decrease from cost to fair value is other than temporary. The System has followed a policy of reviewing all investments that have been below cost by at least 25% for three quarters. Unless specific evidence exists to the contrary, these investments have been reduced to fair value, which becomes the new cost basis. The System recorded \$168,000 and \$2,877,000 of other than temporary impairments on investments in 2009 and 2008, respectively, which is included in investment income, net in the accompanying consolidated statements of operations.

Investment securities, in general, are exposed to various risks. Recent market conditions have resulted in an unusually high degree of volatility and increased the risks and short term liquidity of certain investments held by the System which could impact the value of investments after the date of these consolidated financial statements.

(h) *Property and Equipment*

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements. Costs for repairs and maintenance are expensed as incurred.

Gifts of long-lived assets are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restriction that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must

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be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

The System reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset exceeds its fair value and may not be recoverable.

(i) *Investments In Joint Venture Arrangements*

Investments in joint venture arrangements, generally in the form of partnership interests, are accounted for using the equity method of accounting.

(j) *Fair Value of Financial Instruments*

FASB ASC 820 establishes a framework for measuring fair value which provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under Statement 157 are described below:

- *Level 1* – Inputs into the valuation methodology are the unadjusted quoted prices for identical assets or liabilities in active markets that the System has the ability to access.
- *Level 2* – Inputs into the valuation methodology include quoted prices for similar assets or liabilities in active and inactive markets, other than quoted prices that are observable for specific assets or liabilities, and values that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified contractual term, the value must be observable for substantially the full term of the asset or liability.
- *Level 3* – Inputs into the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Assets held in trust by others represent a donor established perpetual trust held and administered by an outside trustee. The System owns an interest in the trust rather than in the securities underlying the trust, and therefore, it is generally required to consider such investments as Level 3 for the purposes of applying Statement 157. Such classification is based on the inability to redeem the investment, even though the underlying securities may not be difficult to value or may be readily marketable. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes are not necessarily an indication of the risk associated with investing in those investments.

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The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the System believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The carrying amount of patient accounts receivable, accounts payable, and accrued expenses approximate fair value because of the short maturity of these instruments.

(k) Net Asset Categories

To ensure observance of limitations and restrictions placed on the use of resources available to the System, the accounts of the System are maintained in the following net assets categories:

Unrestricted – Unrestricted net assets represent available resources other than donor restricted contributions. Included in unrestricted net assets are assets set aside by the board of directors for future capital improvements or for other purposes, as deemed appropriate.

Temporarily Restricted – Temporarily restricted net assets represent contributions that are restricted by the donor either as to purpose or as to time of expenditure.

Permanently Restricted – Permanently restricted net assets represent contributions received with the donor restriction that the principal be invested in perpetuity and that only the income earned that the trustee does not reinvest be available for operations. The net appreciation of the value of investments held in trust by others remains in permanently restricted net assets until cash is transferred to the System.

(l) Excess of Revenues over Expenses

Excess of revenues over expenses included in the consolidated statements of operations reflects the System's performance measure. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, except for losses that are deemed to be other than temporary, and 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). Nonoperating gains and losses, equity in earnings of joint ventures and adjustments related to minority interest are considered in the performance measure.

(m) Income Taxes

The System, Hospital, and Foundation are tax-exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code and are generally exempt from income taxes. The accompanying consolidated financial statements have been prepared on the basis that this tax-exempt status will be maintained.

SAINT MARY'S HEALTH SYSTEM, INC.

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Scovill, Franklin, Partners, and the PHO are for-profit organizations subject to income taxes. Each organization has experienced operating losses and have accumulated net operating loss carryforwards at September 30, 2009. A valuation allowance has been recorded as management believes realization of such carryforwards is doubtful.

The Surgical Center, Diagnostic Center, and the Indemnity Company are pass-through entities with the tax consequences of their operating results being assessed at the member level.

(n) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Financial statement areas where management applies the use of assumptions and estimates consist primarily of the allowance for uncollectible accounts, third-party reimbursement reserves, the pension liability and the estimated self-insurance liability.

(o) Prior Year Reclassifications

Certain prior year balances have been reclassified in order to be consistent with the current year presentation.

(4) Net Revenue from Patient Services

A substantial portion of net revenue from patient services is derived from funds provided on behalf of patients under federal and state medical assistance programs. Revenue from some of these sources is determined by the application of reimbursement principles and is subject to audit by the applicable agencies. In the opinion of management, such principles have been properly applied in the determination of net patient service revenue. Settlement notices have been received from the Medicare program and the Medicaid program through 2005 and 2000, respectively. Retrospective adjustments for items under appeal by the Hospital or under review by the intermediary, if any, are not expected to have a material adverse effect on the System's consolidated financial position or results of operations.

Net patient service revenues consist of inpatient revenues, principally from routine patient care and ancillary services and outpatient revenues from ancillary services, after considering allowances under agreements with various third-party payors. A reconciliation of gross revenues to net revenues from patient services after allowance for the years ended September 30, 2009 and 2008, is as follows (in thousands):

	<u>2009</u>	<u>2008</u>
Gross revenue from patient services	\$ 531,794	489,613
Contractual and other allowances	(293,158)	(260,720)
Charity care	(493)	(584)
Net revenue from patient services	<u>\$ 238,143</u>	<u>228,309</u>

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During 2007, the State of Connecticut established the Hospital Hardship Fund (the Fund) to be administered by The Department of Social Services. Participation in this program and availability of funding is at the discretion of the State of Connecticut. During 2008 the Hospital received \$3,500,000 in payments from the Fund to supplement amounts paid by the State for services to patients insured under State programs. This amount is recorded in net revenue from patient services in the accompanying consolidated statements of operations. The Hospital did not receive any payments from the Fund in 2009.

The System grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of gross receivables from private pay patients and third-party payors at September 30, 2009 and 2008 was as follows:

	2009	2008
Medicare (including Medicare managed care)	28.2%	25.3%
Medicaid	17.9	24.1
Other third-party payors	27.6	29.4
Private pay patients	26.3	21.2
	100.0%	100.0%

The System's exposure to risk of nonpayment from private pay patients is more significant than other payors. However, the System has recorded an estimate for uncollectible accounts, which, in management's opinion, is sufficient to provide for such risk. This estimate is based on a variety of factors including historical experience, the current economic environment and recent payment patterns.

(5) Regulatory and Legislative Matters

(a) State of Connecticut Regulatory Environment

Connecticut's acute care hospital regulatory system is currently administered by the State of Connecticut Office of Health Care Access (OHCA). The Hospital is subject to a regulatory system that includes the administration of a pool resulting in distribution of monies by the State to the Hospital. The Hospital receives interim payments from the State based upon the Hospital's payment shortfalls for certain payors relative to similar experience of all other hospitals in the State. During 2009 and 2008, the Hospital received \$3,252,000 and \$3,547,000, respectively.

(b) Federal Regulatory Environment

The healthcare 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 healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse and security and privacy of health information. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare 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

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

The following table sets forth by level, within the fair value hierarchy, the System's financial instruments at fair value as of September 30, 2009 (in thousands):

	(Level 1)	(Level 2)	(Level 3)	Total
Cash and cash equivalents	\$ 12,536	—	—	12,536
Corporate bonds	—	2,311	—	2,311
U.S. government and agency obligations	—	7,400	—	7,400
Mutual funds	14,577	—	—	14,577
Equities	4,332	—	—	4,332
Total	31,445	9,711	—	41,156
Assets held in trust by others:				
Perpetual trust	—	—	12,785	12,785
Total	\$ 31,445	9,711	12,785	53,941

The following table presents additional information about investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended September 30, 2009 (in thousands):

	Perpetual trust
Fair value at October 1, 2008	\$ 13,048
Net realized and unrealized gains	223
Appropriation of endowment assets for expenditure	(486)
Fair value at September 30, 2009	\$ 12,785

Assets held in trust by others represents a donor established perpetual trust held and administered by an outside trustee. The System receives a specific portion of the return on the underlying assets of the perpetual trust. The investment income is recorded as unrestricted investment income in nonoperating gains (losses).

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(7) Property and Equipment

A summary of property and equipment at September 30, 2009 and 2008 is as follows (in thousands):

	<u>2009</u>	<u>2008</u>
Land and land improvements	\$ 1,484	1,314
Buildings and building improvements	68,194	65,602
Equipment	101,216	100,423
Projects in process	724	3,010
	<u>171,618</u>	<u>170,349</u>
Less accumulated depreciation and amortization	<u>115,865</u>	<u>113,734</u>
Property and equipment, net	<u>\$ 55,753</u>	<u>56,615</u>

Property under capital leases had a net book value of \$0 and \$262,000 at September 30, 2009 and 2008, respectively.

(8) Long-Term Obligations

In May 1997, the Hospital issued \$36,150,000 of CHEFA Bonds, Series E, dated May 1, 1997, 5.00% – 6.00% Serial and Term Bonds payable annually in amounts ranging from \$985,000 to \$3,000,000 through July 1, 2022.

The Hospital is required to maintain a Debt Service Reserve fund for the Bonds issued through CHEFA, of the lesser of 10% of the principal amount of the Bonds, the amount required to fund the current portion of the principal and interest payable in any year, or 125% of the average annual debt service on the Bonds. The Hospital is also required to comply with certain financial covenants for the Bonds issued through CHEFA, including a Debt Service Coverage Ratio requirement of at least 1.25, a Debt Ratio requirement of no greater than .75 and a Current Ratio requirement of at least 1.40. The Bond agreements indicate that if the Current Ratio is below 1.40 but above 1.0 and the Debt Service Coverage Ratio is below 1.25 but above 1.0, a consultant is required.

Other long-term obligations consist primarily of two capital equipment financing notes: CitiCapital, with interest of 4.7%, beginning August 2002 and maturing July 2009 and HP Financial Services, with interest of 3.7%, beginning December 2004 and maturing November 2011.

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

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Long-term obligations at September 30, 2009 and 2008 are as follows (in thousands):

	<u>2009</u>	<u>2008</u>
CHEFA Series E Bonds, principal payable annually and interest payable in semi-annual installments	\$ 27,915	29,330
Capital equipment financing notes	3,355	4,436
Other including capital leases	—	67
	<u>31,270</u>	<u>33,833</u>
Less unamortized portion of bond discount	(271)	(309)
Less current portion	<u>(2,736)</u>	<u>(2,958)</u>
	<u>\$ 28,263</u>	<u>30,566</u>

Principal payments on the Hospital's long-term obligations and capital lease payments are as follows (in thousands):

	<u>Long-term obligations</u>
Year ending September 30:	
2010	\$ 2,736
2011	2,849
2012	2,363
2013	1,848
2014	1,850
Thereafter	<u>19,624</u>
	<u>\$ 31,270</u>

The CHEFA Series E bonds and capital equipment financing notes are collateralized by substantially all of the Hospital's land, buildings and equipment.

Long-term debt is carried at cost. Fair values are estimated based on quoted market prices for the same or similar issues. The estimated fair value of the CHEFA Series E bonds and capital equipment financing notes approximates \$28,792,000 as of September 30, 2009.

(9) Line of Credit

At September 30, 2008, the Hospital maintained a financing agreement with Webster Bank for a \$5,000,000 line of credit which had an April 30, 2009 maturity date. Interest on the line of credit was at the Hospital's choice of either the lending institution's prime rate or at the LIBOR rate plus 110 basis points. At September 30, 2009, the Hospital is in the process of renewing this line of credit agreement. Additionally, the Hospital has two stand-by letters of credit with Webster Bank totaling \$719,000.

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(10) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2009 and 2008 (in thousands):

	2009	2008
Cancer	\$ 774	946
Building and equipment	225	—
Community services	395	435
Education	249	254
Other	744	717
	\$ 2,387	2,352

Permanently restricted net assets at September 30, 2009 and 2008 are restricted to (in thousands):

	2009	2008
Investments held by trustee in perpetuity, the income from which is expendable to support Hospital operations	\$ 12,813	13,073
Investments held by Hospital Foundation in perpetuity, the income from which is expendable to support:		
Hospital operations	818	818
Medical education	150	150
	\$ 13,781	14,041

(11) Endowment

Effective October 1, 2008, the System adopted FASB Staff Position No. 117-1, Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds (FSP 117-1), now part of FASB ASC 958-205, *Not-for-Profit Entities -- Presentation of Financial Statements*. On October 1, 2007 the Uniform Prudent Management of Institutional Funds Act (UPMIFA) was adopted by the State of Connecticut (Act). The new law updated existing fundamental investment principles providing standards to guide investing in a prudent manner and eliminating the restriction that endowment funds could not be spent below its historical dollar value. The System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds; the duration and preservation of the fund, the purposes of the System and the donor-restricted endowment fund, general economic conditions, the possible effect of inflation and deflation, the expected total return from income and the appreciation of investments, other resources of the System, and the investment policies of the System.

SAINT MARY'S HEALTH SYSTEM, INC.

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The System's endowment consists of funds established for a variety of purposes including donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. At September 30, 2009 and 2008, the System has no funds designated by the Board of Directors as endowment.

The System has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. The Hospital classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the System in a manner consistent with the standard of prudence prescribed by the Act. The adoption of FSP 117-1 required the System to retrospectively reclassify net assets related to accumulated investment earnings from unrestricted to temporarily restricted in the amount of \$91,000.

Endowment funds consist of the following at September 30, 2009 and 2008 (in thousands):

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds at September 30, 2009	\$ 112	13,781	13,893
Donor-restricted endowment funds at September 30, 2008	\$ 91	14,041	14,132

Changes in endowment funds for the year ended September 30, 2009 are as follows (in thousands):

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, October 1, 2008	\$ 91	14,041	14,132
Investment return:			
Investment losses	(32)	(1,995)	(2,027)
Net appreciation	65	2,221	2,286
Total investment return	<u>33</u>	<u>226</u>	<u>259</u>
Appropriation of endowment assets for expenditure	<u>(12)</u>	<u>(486)</u>	<u>(498)</u>
Endowment net assets, September 30, 2009	<u>\$ 112</u>	<u>13,781</u>	<u>13,893</u>

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

Changes in endowment funds for the year ended September 30, 2008 are as follows (in thousands):

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, October 1, 2007	\$ 287	17,002	17,289
Investment return:			
Investment income	41	1,715	1,756
Net depreciation	(205)	(3,608)	(3,813)
Total investment return	<u>(164)</u>	<u>(1,893)</u>	<u>(2,057)</u>
Appropriation of endowment assets for expenditure	<u>(32)</u>	<u>(1,068)</u>	<u>(1,100)</u>
Endowment net assets, September 30, 2008	<u>\$ 91</u>	<u>14,041</u>	<u>14,132</u>

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the System must hold in perpetuity or for a donor-specified period. Funds held in trust by others represents a donor established perpetual trust held and administered by an outside trustee and are not within the System's control as to spending and investment policies.

To satisfy its long term rate-of-return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The System targets a diversified asset allocation that places emphasis on investments in equities and fixed income investments to achieve its long-term return objectives with prudent risk constraints.

The System follows a policy of spending an amount that approximates the investment income earned, in addition to specific purchases of capital equipment. Accordingly, the System expects its spending policy will allow its endowment funds to be maintained in perpetuity by growing at a rate at least equal to the planned payouts. Additional real endowment growth will be provided through new gifts and any excess investment return.

(12) Self-Insurance

Prior to July 1, 2009, the Hospital purchased limits of professional and general liability from Partners Interinsurance Exchange ("PIE") to cover risks up to specified limits. Within PIE the Hospital maintained retentions net to its own account by type of coverage. A claims made reinsurance contract was purchased each fiscal year that provided coverage above these retentions. Beginning January 1, 2002, the professional liability coverage provided for total limits, with respect to professional liability, of \$18 million per claim and \$27 million in the aggregate, with a retention inside that limit of \$3,000,000 per incident applying as net to the Hospital's account within PIE. The general liability coverage provided limits of \$16 million per claim and \$19 million in the aggregate with a retention of \$1,000,000 per incident and \$4,000,000 in the

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

annual aggregate retained as net to the Hospital's account within PIE. The Hospital paid an actuarially determined premium to PIE for the purpose of setting aside assets to cover the reasonable value of ultimate expected loss retained as net within PIE.

During June 2009 the Hospital established the Indemnity Company as a successor to the Hospital's financial interest in PIE. On July 1, 2009 the Hospital's account in PIE was transferred to the Indemnity Company. The Hospital continues to purchase limits of professional and general liability from the Indemnity Company at levels previously purchased from PIE. Actuarially determined premiums are paid in order to set aside assets to cover the reasonable value of ultimate expected losses. Hospital management, along with its consulting actuaries, accrued its best estimate of professional and general liabilities.

Malpractice claims that fall within the Hospital's adopted policy of self-insurance have been asserted against the Hospital by various claimants. The claims are in various stages of assessment and resolution. There are also known and unknown incidents that have occurred through September 30, 2009 that may result in the assertion of additional claims. Hospital management believes that the ultimate settlement of these claims will not have a material impact on the Hospital's consolidated financial position or results of their operations, as adequate self-insurance reserves, Indemnity Company funding and reinsurance are in place.

(13) Retirement Plans

Defined Benefit Plan

The Hospital has a noncontributory, defined benefit pension plan (the Plan) for most employees, which is funded with available cash flow. The Plan is qualified as a "Church Plan" and is therefore exempt from a majority of ERISA regulations. Plan benefits are not guaranteed by the Pension Benefit Guaranty Corporation. The Plan was frozen to new entrants in 1997. In 2004, the Plan's benefits were curtailed to eliminate participants' earnings of additional benefits for future services.

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

The following table sets forth the Plan's funded status at September 30, 2009 and 2008, the Plan measurement date, (in thousands):

	<u>2009</u>	<u>2008</u>
Change in benefit obligation:		
Benefit obligation, beginning of year	\$ 106,805	113,552
Interest cost	6,490	6,644
Actuarial loss (gain)	11,361	(7,917)
Benefits paid	<u>(5,462)</u>	<u>(5,474)</u>
Benefit obligation, end of year	<u>119,194</u>	<u>106,805</u>
Change in plan assets:		
Fair value of plan assets, beginning of year	47,895	60,082
Actual return on plan assets	1,065	(9,713)
Contributions	5,016	3,000
Benefits paid	<u>(5,462)</u>	<u>(5,474)</u>
Fair value of plan assets, end of year	<u>48,514</u>	<u>47,895</u>
Funded status at year end	\$ <u><u>(70,680)</u></u>	<u><u>(58,910)</u></u>
Amounts recognized in consolidated balance sheets consist of:		
Noncurrent liabilities	\$ (70,680)	(58,910)
Accumulated charges to unrestricted net assets	<u>54,400</u>	<u>41,280</u>
Net amount recognized	\$ <u><u>(16,280)</u></u>	<u><u>(17,630)</u></u>

Amounts recognized as accumulated charges to unrestricted net assets consists of (in thousands):

	<u>Pension benefits</u>	
	<u>2009</u>	<u>2008</u>
Net actuarial loss	\$ <u>(54,400)</u>	<u>(41,280)</u>
	\$ <u><u>(54,400)</u></u>	<u><u>(41,280)</u></u>

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

The accumulated benefit obligation for the pension plan was \$119,194,000 and \$106,805,000 at September 30, 2009 and 2008, respectively. Net periodic benefit cost recognized in 2009 and 2008 was (in thousands):

	<u>2009</u>	<u>2008</u>
Components of net periodic benefit cost:		
Interest cost	\$ 6,490	6,644
Expected return on plan assets	(4,465)	(4,393)
Net amortization and deferral	<u>1,642</u>	<u>2,216</u>
Net periodic benefit cost	<u>\$ 3,667</u>	<u>4,467</u>

Other changes in plan assets and benefit obligation recognized as charges to unrestricted net assets in 2009 and 2008 are as follows (in thousands):

	<u>2009</u>	<u>2008</u>
Net loss	\$ (11,478)	(1,756)
Net amortization and deferral	<u>(1,642)</u>	<u>(2,216)</u>
Reductions recognized in charges to unrestricted net assets	<u>\$ (13,120)</u>	<u>(3,972)</u>
Decrease to unrestricted net assets associated with recognized net periodic benefit cost	<u>\$ 16,787</u>	<u>8,439</u>

Weighted average assumptions used to determine benefit obligations and net benefit cost as of and for the years end September 30, 2009 and 2008 were as follows:

	<u>2009</u>	<u>2008</u>
Weighted-average assumptions at September 30:		
Discount rate for benefit obligations	5.50%	6.25%
Discount rate for net periodic benefit cost	6.25%	6.00%
Expected return on plan assets	8.00%	8.00%

The pension plan weighted average asset allocations at September 30, 2009 and 2008 by asset category are as follows:

	<u>2009</u>	<u>2008</u>
Equity securities	59%	52%
Money market funds	2	13
Debt securities:		
U.S. obligations	14	13
Corporate	24	21
Fixed income mutual funds	<u>1</u>	<u>1</u>
	<u>100%</u>	<u>100%</u>

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

The expected long-term rate of return for the plan's total assets is based on the expected return of each of the above categories, weighted based on the target allocation of each class. Equity securities are expected to return 9% to 10% over the long-term, while debt securities are expected to return between 4% and 7%. Money market funds are held to pursue market opportunities.

The investment policy, as established by the Investment Committee, is to earn a total return in any five-year period that will have exceeded the interest assumption in the actuarial plan valuation for that five-year period. For performance evaluation purposes, all rates of return will be examined on a net-of-fee basis. The pension assets are to be broadly diversified so as to limit the impact of large losses in individual investments on the total portfolio. The asset allocation is reviewed on a quarterly basis.

In the aggregate, contributions to the pension plan are expected to be \$5,800,000 in 2010.

The following benefit payments are expected to be paid (in thousands):

2010	\$	5,713
2011		6,026
2012		6,333
2013		6,660
2014		7,145
2015 through 2018		40,404
	\$	<u>72,281</u>

Defined Contribution Plan

The Hospital established a defined contribution plan when it reduced the benefits of the Plan via amendment in 1997. The defined contribution plan provides for a Hospital match up to a certain percentage of employee contributions. Expenses related to the defined contribution plan amounted to \$3,459,000 and \$3,403,000 in 2009 and 2008, respectively, and are included in employee benefits in the accompanying consolidated statements of operations.

Supplemental Pension Plan

In addition, the Hospital has an unfunded supplemental pension plan for the benefit of three retired long term employees. The Hospital recorded a liability of \$957,000 and \$908,000 at September 30, 2009 and 2008, respectively. Expenses related to the plan amounted to \$80,000 and \$80,000 in 2009 and 2008, respectively, and are included in employee benefits in the accompanying consolidated statements of operations.

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(14) Leases and Rental Expenses

Rental expense aggregated approximately \$4,906,000 and \$4,455,000 for the years ended September 30, 2009 and 2008, respectively. Minimum future rental commitments on all noncancelable operating leases with initial or remaining terms of more than one year are as follows (in thousands):

Fiscal year:		
2010	\$	2,709
2011		2,385
2012		1,815
2013		1,603
2014		1,481
2015 and thereafter		10,145
	\$	<u>20,138</u>

The Hospital rents space from SMHS in a medical office building for approximately \$9,000 per month.

(15) Cancer Center

During 1997, the Hospital entered into an agreement with Waterbury Hospital to develop a joint Cancer Care Center, known as the Harold Leever Regional Cancer Center (HLRCC) that provides treatment services to cancer patients in the greater Waterbury area. The Hospital is entitled to distributions at the discretion of HLRCC's Board of Directors, which is selected by Waterbury Hospital and the Hospital on a 50/50 basis. The Hospital advanced \$1,386,298 to HLRCC during its development. In December 2003, the Hospital's initial investment in HLRCC was converted into a \$1,386,298 promissory note. This note accrues interest at 4% per year. Interest is due in quarterly installments starting March 31, 2004. Principal and interest is due in monthly installments starting March 31, 2009. HLRCC opened for operations in October 2002. The Hospital's investment in HLRCC is approximately \$8,002,000 and \$6,954,000 at September 30, 2009 and 2008, respectively. Equity in earnings was approximately \$1,304,000 and \$1,252,000 in 2009 and 2008, respectively.

(16) Heart Center of Greater Waterbury

In December 2003, the Hospital and Waterbury Hospital were granted permission to establish a three-year demonstration project for an advanced cardiac care program known as the Heart Center of Greater Waterbury, Inc. (HCGW). The program has been granted permanent program status. Through the program, patients at the Hospital and Waterbury Hospital are provided access to services such as angioplasty and open heart surgery. Procedures are performed at both hospitals, each recording related revenues and expenses. The HCGW, a MSO that provides administrative support and management functions to the program, has a Board of Directors selected by Waterbury Hospital and the Hospital on a 50/50 basis. HCGW incurs costs, which are funded by the hospitals, to market the program and derives no net assets from its activities. The Hospital expensed \$438,000 and \$408,000 of funding, in 2009 and 2008, respectively.

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(17) Other Operating Revenues

Components of other operating revenues for the years ended September 30, 2009 and 2008 are as follows (in thousands):

	2009	2008
Investment income related to short-term investments and investments for self-insurance	\$ 432	862
Net assets released from restriction	22	31
Contributions	1,073	833
Cafeteria	1,009	955
Outside services	1,012	1,077
State grants	552	948
Parking fees	682	709
Day care	670	644
Discounts	23	75
Rentals	1,219	138
Other	891	571
Total	\$ 7,585	6,843

(18) Functional Expenses

The System provides general health care services to residents within its geographic location. Expenses related to providing these services for the years ended September 30, 2009 and 2008 are as follows (in thousands):

	2009	2008
Health care services	\$ 205,042	197,760
General and administrative	31,780	33,772
Fundraising	738	814
	\$ 237,560	232,346

(19) Investments in Joint Venture Arrangements

Naugatuck Valley MRI Limited Partnership

The Hospital is a 1% general partner and a 47% limited partner in the Naugatuck Valley MRI Limited Partnership, which provides diagnostic imaging services in Waterbury. The investment is carried on the equity basis, and the carrying value is approximately \$303,000 and \$425,000 at September 30, 2009 and 2008, respectively. Equity in earnings was approximately \$731,000 and \$928,000 in 2009 and 2008, respectively.

SAINT MARY'S HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

Health Connecticut LLC

The Hospital is a 4.55% limited partner in Health Connecticut LLC, which provides healthcare through a preferred provider organization network in the State of Connecticut. The investment is carried on the equity basis, and the carrying value is \$28,000 at September 30, 2009 and 2008. There were no equity in earnings recognized in 2009 and 2008.

(20) Activities Between Affiliates

During 2009 and 2008, the Foundation distributed \$287,000 and \$969,000, respectively, to the Hospital to support programs and services.

In addition to the lease activity with affiliates described in note 14, all employees of SMHS and the Foundation are paid through the Hospital's payroll system, and the amounts paid are charged directly to the related affiliate. In addition, time spent by certain Hospital employees on affiliate activities is charged to the related affiliate.

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidating Balance Sheet

September 30, 2009

(In thousands)

	Saint Mary's Hospital, Inc. Consolidated	Saint Mary's Hospital Foundation Inc.	Saint Mary's Health System Inc.	Saint Mary's PHO, Inc.	Eliminations	Saint Mary's Health System, Inc. Consolidated
Current assets:						
Cash and cash equivalents	\$ 21,728	1,428	57	—	—	23,213
Short-term investments	1,082	—	—	—	—	1,082
Current portion of assets whose use is limited	4,739	—	—	—	—	4,739
Accounts receivable, net	25,522	262	—	—	—	25,784
Other current assets	3,601	21	344	—	—	3,966
Total current assets	<u>56,672</u>	<u>1,711</u>	<u>401</u>	<u>—</u>	<u>—</u>	<u>58,784</u>
Marketable securities	<u>11,261</u>	<u>2,771</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>14,032</u>
Assets whose use is limited:						
By donor and held in trust by others	12,785	—	—	—	—	12,785
For estimated self-insurance liability	25,793	—	—	—	—	25,793
By bond indenture	5,873	—	—	—	—	5,873
Net interest in Foundation	4,270	—	—	—	(4,270)	—
Other	6	—	—	—	—	6
Total assets whose use is limited	<u>48,727</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(4,270)</u>	<u>44,457</u>
Less current portion of assets whose use is limited	<u>4,739</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>4,739</u>
Noncurrent assets whose use is limited	<u>43,988</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(4,270)</u>	<u>39,718</u>
Property and equipment, net	<u>54,378</u>	<u>9</u>	<u>1,366</u>	<u>—</u>	<u>—</u>	<u>55,753</u>
Other assets:						
Investments in joint venture arrangements	8,614	—	—	—	—	8,614
Deferred financing costs, net	250	—	—	—	—	250
Other noncurrent assets	441	—	241	—	—	682
Total other assets	<u>9,305</u>	<u>—</u>	<u>241</u>	<u>—</u>	<u>—</u>	<u>9,546</u>
Total assets	<u>\$ 175,604</u>	<u>4,491</u>	<u>2,008</u>	<u>—</u>	<u>(4,270)</u>	<u>177,833</u>

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidating Balance Sheet

September 30, 2009

(In thousands)

	Saint Mary's Hospital, Inc. Consolidated	Saint Mary's Hospital Foundation, Inc.	Saint Mary's Health System Inc.	Saint Mary's PHO, Inc.	Eliminations	Saint Mary's Health System, Inc. Consolidated
Current liabilities:						
Current portion of long-term obligations	\$ 2,736	—	—	—	—	2,736
Accounts payable	11,251	153	28	—	—	11,432
Salaries, wages, and payroll withholdings	7,104	—	—	—	—	7,104
Due to third-party payors, net	6,847	—	—	—	—	6,847
Accrued expenses and other current liabilities	8,537	68	—	—	—	8,605
Total current liabilities	<u>36,475</u>	<u>221</u>	<u>28</u>	<u>—</u>	<u>—</u>	<u>36,724</u>
Long-term liabilities:						
Long-term obligations, net of current portion	28,263	—	—	—	—	28,263
Estimated self-insurance liability	16,848	—	—	—	—	16,848
Pension and deferred compensation	71,557	—	—	—	—	71,557
Other long-term liabilities	9,443	—	—	—	—	9,443
Total long-term liabilities	<u>126,111</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>126,111</u>
Minority interest in subsidiaries	<u>1,855</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,855</u>
Net assets (deficit):						
Unrestricted	(5,005)	1,628	1,980	—	(1,628)	(3,025)
Temporarily restricted	2,387	1,674	—	—	(1,674)	2,387
Permanently restricted	13,781	968	—	—	(968)	13,781
Total net assets	<u>11,163</u>	<u>4,270</u>	<u>1,980</u>	<u>—</u>	<u>(4,270)</u>	<u>13,143</u>
Total liabilities and net assets	<u>\$ 175,604</u>	<u>4,491</u>	<u>2,008</u>	<u>—</u>	<u>(4,270)</u>	<u>177,833</u>

See accompanying independent auditors' report.

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidating Statement of Operations

Year ended September 30, 2009

(In thousands)

	Saint Mary's Hospital, Inc. Consolidated	Saint Mary's Hospital Foundation, Inc.	Saint Mary's Health System Inc.	Saint Mary's PHO, Inc.	Eliminations	Saint Mary's Health System, Inc. Consolidated
Revenues:						
Net revenue from patient services	\$ 238,143	—	—	—	—	238,143
Other operating revenues	6,580	755	364	—	(114)	7,585
Total revenues	<u>244,723</u>	<u>755</u>	<u>364</u>	<u>—</u>	<u>(114)</u>	<u>245,728</u>
Expenses:						
Salaries and wages	102,189	280	38	—	—	102,507
Employee benefits	27,701	70	11	—	—	27,782
Supplies and other expenses	83,122	370	67	—	(102)	83,457
Provision for uncollectible accounts	13,149	12	—	—	—	13,161
Depreciation and amortization	8,675	2	73	—	—	8,750
Interest	1,899	4	—	—	—	1,903
Total expenses	<u>236,735</u>	<u>738</u>	<u>189</u>	<u>—</u>	<u>(102)</u>	<u>237,560</u>
Operating income	<u>7,988</u>	<u>17</u>	<u>175</u>	<u>—</u>	<u>(12)</u>	<u>8,168</u>
Nonoperating gains (losses):						
Investment income, net	(1,247)	—	—	—	(24)	(1,271)
Equity in earnings of joint ventures	2,051	—	—	—	—	2,051
Minority interest in subsidiaries	(1,043)	—	—	—	—	(1,043)
Change in net assets of Foundation	(28)	—	—	—	28	—
Net loss on disposal of assets	(91)	—	—	—	—	(91)
Other	639	—	—	—	—	639
Total nonoperating gains (losses), net	<u>281</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>4</u>	<u>285</u>
Excess of revenues over expenses	<u>8,269</u>	<u>17</u>	<u>175</u>	<u>—</u>	<u>(8)</u>	<u>8,453</u>
Net assets released from restriction for capital expenditures	150	—	—	—	—	150
Capital transactions with affiliates	4	(12)	54	(54)	8	—
Change in unrealized gains on marketable securities and other assets whose use is limited	638	187	—	—	(187)	638
Change in accumulated pension charges to unrestricted net assets	(13,120)	—	—	—	—	(13,120)
Other						
(Decrease) increase in net assets	<u>\$ (4,059)</u>	<u>192</u>	<u>229</u>	<u>(54)</u>	<u>(187)</u>	<u>(3,879)</u>

See accompanying independent auditors' report.