



AUDITED FINANCIAL STATEMENTS

The Milford Hospital, Incorporated  
Years Ended September 30, 2010 and 2009  
With Report of Independent Auditors

Ernst & Young LLP



# The Milford Hospital, Incorporated

## Audited Financial Statements

Years Ended September 30, 2010 and 2009

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## Report of Independent Auditors

The Board of Directors  
The Milford Hospital, Incorporated

We have audited the accompanying balance sheets of The Milford Hospital, Incorporated (the Hospital) as of September 30, 2010 and 2009, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Hospital's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital'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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Milford Hospital, Incorporated at September 30, 2010 and 2009, and the results of its operations and changes in net assets, and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

A handwritten signature in cursive script that reads 'Ernst & Young LLP'.

February 23, 2011

# The Milford Hospital, Incorporated

## Balance Sheets

	<b>September 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 303,667	\$ 1,078,653
Short-term investments	223,228	221,990
Patient accounts receivable, less allowance for uncollectible accounts of approximately \$4,512,000 in 2010 and \$6,169,000 in 2009	12,226,798	13,535,241
Inventories	748,785	778,225
Prepaid expenses and other	1,342,410	1,328,796
Total current assets	14,844,888	16,942,905
Investments	27,793,697	29,687,316
Assets limited as to use	1,799,385	1,743,239
Property, plant, and equipment:		
Land and improvements	1,545,184	1,545,184
Building and improvements	38,433,808	38,311,785
Equipment	32,107,653	31,246,590
Construction-in-progress	238,283	644,126
	72,324,928	71,747,685
Less accumulated depreciation	(45,954,913)	(42,570,348)
	26,370,015	29,177,337
Interest in Milford Hospital Foundation, Inc.	777,498	749,093
Due from affiliates	719,613	577,526
Mortgage receivable from affiliate	-	642,750
	1,497,111	1,969,369
Total assets	\$ 72,305,096	\$ 79,520,166

	<b>September 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	<b>\$ 3,958,361</b>	\$ 4,324,984
Accrued employee compensation	<b>5,811,602</b>	6,257,395
Other accrued liabilities	<b>3,133,999</b>	2,990,484
Due to third-party reimbursement agencies	<b>1,885,402</b>	2,372,068
Current portion of notes payable to bank	<b>892,497</b>	833,487
Total current liabilities	<b>15,681,861</b>	16,778,418
Notes payable to bank, less current portion	<b>1,891,051</b>	2,783,548
Accrued pension and other liabilities	<b>27,920,210</b>	21,859,301
Net assets:		
Unrestricted	<b>25,485,476</b>	36,805,806
Temporarily restricted	<b>716,206</b>	689,851
Permanently restricted	<b>610,292</b>	603,242
Total net assets	<b>26,811,974</b>	38,098,899
Total liabilities and net assets	<b>\$ 72,305,096</b>	\$ 79,520,166

*See accompanying notes.*

## The Milford Hospital, Incorporated

### Statements of Operations and Changes in Net Assets

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
Operating revenues:		
Net revenues from services to patients	<b>\$ 78,615,925</b>	\$ 82,829,045
Other operating revenues	<b>779,865</b>	749,027
	<b>79,395,790</b>	83,578,072
Operating expenses:		
Salaries and wages	<b>37,361,201</b>	37,172,912
Supplies and other	<b>37,879,115</b>	39,588,961
Provision for uncollectible accounts	<b>6,738,669</b>	6,998,451
Depreciation	<b>3,574,898</b>	3,973,806
Interest	<b>230,967</b>	280,961
Professional fees	<b>262,888</b>	472,382
	<b>86,047,738</b>	88,487,473
Operating loss	<b>(6,651,948)</b>	(4,909,401)
Nonoperating income (loss):		
Investment income (loss), net	<b>1,715,094</b>	(2,269,354)
Deficiency of revenues over expenses before change in unrealized gains and losses on investments	<b>(4,936,854)</b>	(7,178,755)
Change in unrealized gains and losses on investments	<b>1,110,476</b>	3,551,963
Deficiency of revenues over expenses	<b>(3,826,378)</b>	(3,626,792)

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The Milford Hospital, Incorporated

Statements of Operations and Changes in Net Assets (continued)

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
Unrestricted net assets:		
Deficiency of revenues over expenses (continued)	\$ (3,826,378)	\$ (3,626,792)
Net assets released from restrictions for capital	1,138	4,483
Net asset transfers to Milford Health and Medical, Inc.	(1,943,756)	(1,668,843)
Change in pension funding obligation	(5,551,334)	(5,487,647)
Decrease in unrestricted net assets	<b>(11,320,330)</b>	(10,778,799)
Temporarily restricted net assets:		
Net assets released from restrictions for capital	(1,138)	(4,483)
Interest income	1,138	4,483
Change in equity interest of Milford Hospital Foundation, Inc.	26,355	87,460
Increase in temporarily restricted net assets	<b>26,355</b>	87,460
Permanently restricted net assets:		
Restricted gifts	5,000	5,000
Change in equity interest of Milford Hospital Foundation, Inc.	2,050	5,000
Increase in permanently restricted net assets	<b>7,050</b>	10,000
Decrease in net assets	<b>(11,286,925)</b>	(10,681,339)
Net assets at beginning of year	<b>38,098,899</b>	48,780,238
Net assets at end of year	<b>\$ 26,811,974</b>	\$ 38,098,899

*See accompanying notes.*

# The Milford Hospital, Incorporated

## Statements of Cash Flows

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Operating activities</b>		
Change in net assets	\$ (11,286,925)	\$ (10,681,339)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Noncash items:		
Provision for uncollectible accounts	6,738,669	6,998,451
Depreciation	3,574,898	3,973,806
Change in unrealized gains and losses on investments	(1,110,476)	(3,551,963)
Change in pension funding obligation	5,551,334	5,487,647
Net asset items:		
Net asset transfers	1,943,756	1,668,843
Change in equity interest in Milford Hospital Foundation, Inc.	(28,405)	(92,460)
Restricted gifts	(5,000)	(5,000)
Changes in assets and liabilities:		
Patient accounts receivable	(5,430,226)	(7,167,095)
Due from affiliates	(142,087)	69,138
Inventories	29,440	78,126
Prepaid expenses and other	(13,614)	97,539
Investments classified as trading	3,004,095	6,339,234
Accounts payable	(366,623)	(791,675)
Accrued employee compensation	(445,793)	463,051
Other accrued liabilities	143,515	859,667
Due to third-party reimbursement agencies	(486,666)	158,708
Accrued pension and other liabilities	509,575	839,250
Net cash provided by operating activities	2,179,467	4,743,928
<b>Investing activities</b>		
Net purchases of property, plant, and equipment	(767,576)	(2,457,628)
Net purchases of short-term investments	(1,238)	(3,237)
Decrease in mortgage receivable from affiliate	642,750	11,423
Increase in assets limited as to use	(56,146)	(16,744)
Net cash used in investing activities	(182,210)	(2,466,186)

The Milford Hospital, Incorporated  
 Statements of Cash Flows (continued)

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Financing activities</b>		
Payments made on notes payable to bank	\$ (833,487)	\$ (778,379)
Restricted gifts	5,000	5,000
Net asset transfers	(1,943,756)	(1,668,843)
Net cash used in financing activities	(2,772,243)	(2,442,222)
Decrease in cash and cash equivalents	(774,986)	(164,480)
Cash and cash equivalents at beginning of year	1,078,653	1,243,133
Cash and cash equivalents at end of year	\$ 303,667	\$ 1,078,653

*See accompanying notes.*

# The Milford Hospital, Incorporated

## Notes to Financial Statements

September 30, 2010

### **1. Organization and Accounting Policies**

#### **Organization**

The Milford Hospital, Incorporated (the Hospital), a voluntary tax-exempt acute care hospital incorporated under the General Statutes of the State of Connecticut, is a subsidiary of Milford Health and Medical, Inc. (the Parent). The Board of Directors (the Board) of the Hospital, appointed by the Parent, controls the operations of the Hospital. Also, the Milford Hospital Foundation, Inc. is a subsidiary of the Parent, and functions as the fund-raising affiliate for the Hospital.

#### **Estimates and Assumptions**

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and contingent liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reported period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

#### **Regulatory Matters**

The Hospital is required to file annual operating information with the State of Connecticut Office of Health Care Access.

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

The Hospital considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Short-term investments consist of bank certificates of deposit. Cash and cash equivalents are maintained with domestic financial institutions with deposits that exceed federally insured limits. It is the Hospital's policy to monitor the strength of these institutions.

#### **Inventories**

Inventories are stated at the lower of cost or market. The Hospital values its inventories using the first-in, first-out method.

# The Milford Hospital, Incorporated

## Notes to Financial Statements (continued)

### **1. Organization and Accounting Policies (continued)**

#### **Fair Value of Financial Instruments**

The carrying value of financial instruments classified as current assets and current liabilities as of September 30, 2010 and 2009 approximate fair value based on current market conditions. The fair value of each financial instrument is disclosed in the respective notes and in Note 4.

#### **Investments**

The Hospital's investment portfolio is classified as trading, with unrealized gains and losses included in the deficiency of revenues over expenses.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value at the balance sheet date. Assets temporarily restricted (by donor) are recorded at fair value at the date of donation, which is then considered cost.

Alternative investments (nontraditional, not-readily-marketable assets) are stated at fair value as estimated in an unquoted market. Individual investment holdings within the alternative investments may, in turn, include investments in both nonmarketable and market-traded securities. Valuations of these investments and, therefore, the Hospital's holdings, may be determined by the investment manager or general partner. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. Generally, fair value reflects net contributions to the investee and an ownership share of realized and unrealized investment income and expenses. The investments may indirectly expose the Hospital to securities lending, short sales of securities, and trading in futures and forwards contracts, options, swap contracts, and other derivative products. While these financial instruments may contain varying degrees of risk, the Hospital's risk with respect to such transactions is limited to its capital balance in each investment. The financial statements of the investees are audited annually by independent auditors.

Investment income (loss), including realized and unrealized gains and losses on investments, interest, and dividends, is included in nonoperating income (loss) unless the income or loss is restricted by the donor or law. The cost of securities sold is based on the specific identification method.

# The Milford Hospital, Incorporated

## Notes to Financial Statements (continued)

### **1. Organization and Accounting Policies (continued)**

#### **Assets Limited As To Use**

Assets limited as to use primarily consist of interest bearing deposits in banks which have been set aside by the Board and restricted by donors for future capital improvements or purchases of equipment. Except for the assets restricted by donors, the Board retains control of funds it has set aside and may, at its discretion, subsequently use these funds for other purposes.

#### **Patient Accounts Receivable**

Patient accounts receivable result from the health care services provided by the Hospital. Additions to the allowance for uncollectible accounts result from the provision for uncollectible accounts. Accounts written off as uncollectible are deducted from the allowance for uncollectible accounts.

The amount of the allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in Medicare and Medicaid health care coverage and other collection indicators. See Note 2 for additional information relative to third-party payor programs.

The Hospital's primary concentration of credit risk is patient accounts receivable, which consists of amounts owed by various governmental agencies, insurance companies, and private patients. The Hospital manages the receivables by regularly reviewing its patient accounts and contracts, and by providing appropriate allowances for uncollectible amounts. Significant concentrations of gross patient accounts receivable include 37% and 35% for Medicare, and 10% for Medicaid, for the fiscal years ending September 30, 2010 and 2009, respectively.

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

Property, plant, and equipment is stated on the basis of cost. Depreciation of property, plant, and equipment is provided using the straight-line method over their estimated useful lives.

#### **Restricted Net Assets**

Temporarily restricted net assets are those where use by the Hospital has been limited by donors to a specific time frame or purpose. All of the Hospital's temporarily restricted net assets are restricted for capital expenditures. Permanently restricted net assets are amounts to be held in perpetuity, the income of which can be used for capital expenditures.

The Milford Hospital, Incorporated  
Notes to Financial Statements (continued)

**1. Organization and Accounting Policies (continued)**

**Donor-Restricted Gifts**

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are included in nonoperating income in the accompanying statements of operations and changes in net assets.

**Deficiency of Revenues Over Expenses**

The statements of operations and changes in net assets include the deficiency of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from the deficiency of revenues over expenses, consistent with industry practice, include 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 change in pension funding obligation.

**Nonoperating Income (Loss)**

Activities, other than in connection with providing healthcare services, are considered to be nonoperating. Nonoperating income (loss) primarily consists of income (loss) on invested funds and unrestricted gifts.

**Interest in Milford Hospital Foundation, Inc.**

The interest in Milford Hospital Foundation, Inc. represents the Hospital's interest in net assets of The Milford Hospital Foundation, Inc. This investment is accounted for in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-20, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*.

# The Milford Hospital, Incorporated

## Notes to Financial Statements (continued)

### 1. Organization and Accounting Policies (continued)

#### Income Taxes

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code), and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Hospital has losses from unrelated business activities of approximately \$5,834,000. A deferred tax asset for these losses of approximately \$2,334,000 is offset by a corresponding valuation allowance of the same amount.

#### Subsequent Events

The Hospital evaluates the impact of subsequent events, which are events that occur after the balance sheet date but before the financial statements are issued, for potential recognition in the financial statements as of the balance sheet date. For the year ended September 30, 2010, the Hospital evaluated subsequent events through February 23, 2011, which is the date the financial statements were available to be issued. No events occurred that require disclosure or adjustment to the financial statements.

#### Adoption of New Accounting Standards

In December 2008, the FASB issued additional authoritative guidance regarding an employer's disclosures about postretirement benefit plan assets, currently included in ASC 715. This guidance requires disclosure about the major classes of postretirement benefit plan assets, including a description of the inputs and valuation techniques used to measure those assets and the designation of such assets by level; how investment allocation decisions are made; the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period; and significant concentrations of risk within plan assets. See Note 7 for these additional disclosures for the year ended September 30, 2010. The adoption of this guidance did not have a significant impact on the Hospital's financial statements for the year ended September 30, 2010.

Effective October 1, 2009, the Hospital adopted the provisions of ASC 740-10, *Accounting for Uncertainty of Income Taxes* (ASC 740-10). ASC 740-10 provides guidance to all enterprises for how uncertain tax provisions should be recognized, measured, presented, and disclosed in the financial statements. The adoption of ASC 740-10 did not have an impact on the Hospital's financial position, results of operations or cash flows for the year ended September 30, 2010.

The Milford Hospital, Incorporated  
Notes to Financial Statements (continued)

**1. Organization and Accounting Policies (continued)**

**New Accounting Standards**

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Improving Disclosures about Fair Value Measurements*, (ASU 2010-06). ASU 2010-06 amended ASC 820 to clarify certain existing fair value disclosures and require a number of additional disclosures. The guidance in ASU 2010-06 clarified that disclosures should be presented separately for each “class” of assets and liabilities measured at fair value and provided guidance on how to determine the appropriate classes of assets and liabilities to be presented. ASU 2010-06 also clarified the requirement for entities to disclose information about both the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. In addition, ASU 2010-06 introduced new requirements to disclose the amounts (on a gross basis) and reasons for any significant transfers between Levels 1, 2 and 3 of the fair value hierarchy and present information regarding the purchases, sales, issuances and settlements of Level 3 assets and liabilities on a gross basis. With the exception of the requirement to present changes in Level 3 measurements on a gross basis, which is delayed until 2011, the guidance in ASU 2010-06 becomes effective for reporting periods beginning after December 15, 2009. Management is currently evaluating the effect that the provisions of ASU 2010-06 will have on the financial statements.

**2. Revenues from Services to Patients and Charity Care**

The following table summarizes net revenues from services to patients:

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
Gross revenues from services to patients	<b>\$ 204,296,146</b>	\$ 219,139,563
Deductions:		
Allowances	<b>125,381,192</b>	136,188,461
Charity care	<b>299,029</b>	122,057
	<b>125,680,221</b>	136,310,518
	<b>\$ 78,615,925</b>	\$ 82,829,045

## The Milford Hospital, Incorporated

### Notes to Financial Statements (continued)

#### **2. Revenue from Services to Patients and Charity Care (continued)**

During fiscal years 2010 and 2009, the Hospital's net revenues from services to patients were 39% from Medicare, 6% and 5% from Medicaid, and 16% and 15% from Blue Cross (governmental payors include managed Medicare and Medicaid business), respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term. The Hospital believes that 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 except as disclosed in Note 9. 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. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

Patient accounts receivable and revenues are recorded when patient services are performed. The Hospital has agreements with certain third-party payors, including health maintenance organizations, that provide for payments to the Hospital at amounts different from the Hospital's established billing rates. These differences are accounted for as allowances. Under these agreements, the Hospital receives reimbursement based on a number of different arrangements, including fee-for-service 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. Revenue under third-party payor agreements is subject to audit and retroactive adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Retroactive adjustments related to settlements with third-party payors for previous fiscal years decreased net patient service revenue by approximately \$119,800 and \$22,000 for the years ended September 30, 2010 and 2009, respectively.

The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to the established policies of the Hospital. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Hospital utilizes the generally recognized poverty income levels for the state, but also includes certain cases where incurred charges are significant when compared to incomes. These charges are not included in net revenues from services to patients for financial reporting purposes.

The Milford Hospital, Incorporated  
Notes to Financial Statements (continued)

**3. Investments**

Investments are stated at fair value, as determined through published market valuations, and are comprised of the following at September 30:

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	\$ 2,043,741	\$ 1,600,963
U.S. Treasury issues	4,095,380	5,966,860
Corporate debt securities	2,922,409	5,886,096
Equity securities	18,676,363	16,109,738
Accrued interest	55,804	123,659
	<u>\$ 27,793,697</u>	<u>\$ 29,687,316</u>

Assets limited as to use are stated at fair value, as determined through published market valuations, and are comprised of the following at September 30:

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	\$ 324,110	\$ 108,172
Certificates of deposit	604,722	104,288
U.S. Treasury issues	466,878	1,134,728
Corporate debt securities	296,038	294,940
Equity securities	103,771	95,532
Accrued interest	3,866	5,579
	<u>\$ 1,799,385</u>	<u>\$ 1,743,239</u>

The components of investment earnings, included in nonoperating income (loss), include the following for the years ended September 30:

	<u>2010</u>	<u>2009</u>
Interest income	\$ 51,325	\$ 80,119
Dividend income	502,530	933,885
Realized capital gains and losses	1,161,239	(3,283,357)
Investment income, net	<u>1,715,094</u>	<u>(2,269,354)</u>
Change in unrealized gains and losses on investments	1,110,476	3,551,963
Total return on investments	<u>\$ 2,825,570</u>	<u>\$ 1,282,609</u>

## The Milford Hospital, Incorporated

### Notes to Financial Statements (continued)

#### 4. Fair Value of Financial Instruments

As defined in ASC 820-10, fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, ASC 820-10 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable inputs that are based on inputs not quoted in active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data are available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, the Hospital utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. In addition, the Hospital considers counterparty credit risk in its assessment of fair value.

Financial assets and liabilities carried at fair value as of September 30, 2010 are classified in the table below in one of the three categories described above:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets</b>				
Cash and cash equivalents	\$ 303,667	\$ –	\$ –	\$ 303,667
Short-term investments	223,228	–	–	223,228
Investments:				
Equity securities	17,586,033	–	–	17,586,033
Cash and cash equivalents	2,043,741	–	–	2,043,741
U.S. Treasury issues	4,095,380	–	–	4,095,380
Corporate debt securities	2,922,409	–	–	2,922,409
Assets whose use is limited:				
Equity securities	103,771	–	–	103,771
Cash and cash equivalents	928,832	–	–	928,832
U.S. Treasury issues	466,878	–	–	466,878
Corporate debt securities	296,038	–	–	296,038

# The Milford Hospital, Incorporated

## Notes to Financial Statements (continued)

### 4. Fair Value of Financial Instruments (continued)

Fair value for Level 1 is based upon quoted market prices. The amounts in the above table exclude assets invested in the Hospital's pension plan (see Note 5).

The amounts reported in the table above do not include alternative investments totaling approximately \$1,090,000 that are accounted for under the equity method of accounting.

### 5. Debt

The Hospital has a mortgage note arrangement with a bank secured by Hospital property. The Hospital pays principal and interest at a fixed rate of 6.86% over a ten-year term. At September 30, 2010 and 2009, the Hospital had an unpaid principal balance of \$2,783,548 and \$3,617,035, respectively. The mortgage note has a maturity date of August 15, 2013. Interest paid during fiscal years 2010 and 2009 amounted to \$219,864 and \$275,129, respectively.

Future minimum principal payments during each of the next five fiscal years, and in the aggregate, were as follows at September 30, 2010:

2011	\$ 892,497
2012	955,684
2013	935,367
	<u>\$ 2,783,548</u>

### 6. Pension Plan

The Hospital has a defined benefit cash balance pension plan (the Plan) covering substantially all of its employees. Plan benefits are based on years of service and the employee's compensation. Contributions to the Plan are intended to provide for benefits attributed to services rendered to date and benefits expected to be earned in the future. Plan participants earn a return based on an interest rate established annually at the beginning of the pay year. Plan participants will vest in their benefits on a percentage basis with years of service.

Effective August 26, 2009, the Hospital's Executive Committee of the Board of Directors adopted a resolution to freeze the Plan for non-union employees effective December 31, 2009. As a result of this resolution, the Plan liabilities were remeasured for non-union employees as of September 30, 2009. All outstanding prior service cost related to these employees totaling \$576,155 was expensed as of the date of the remeasurement. This amount was included in supplies and other within operating expenses in the accompanying statement of operations for the year ended September 30, 2009.

## The Milford Hospital, Incorporated

### Notes to Financial Statements (continued)

#### 6. Pension Plan (continued)

Included in unrestricted net assets at September 30, 2010 and 2009, respectively, are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service cost of \$291,741 and \$360,674 and unrecognized actuarial loss of \$16,903,550 and \$11,283,283. The prior service cost and actuarial loss included in unrestricted net assets, and expected to be recognized in net periodic pension cost during the year ending September 30, 2011, are \$68,933 and \$1,321,987, respectively.

The following table presents a reconciliation of the beginning and ending balances of the Plan's projected benefit obligation and the fair value of plan assets, as well as the funded status of the Plan and accrued pension cost included in the financial statements:

	<b>September 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	\$ 69,739,738	\$ 60,216,942
Service cost	1,744,674	2,154,644
Interest cost	3,984,156	4,042,228
Benefits paid	(3,710,820)	(2,228,711)
Actuarial loss	8,509,525	14,158,603
Reduction due to curtailment	-	(8,603,968)
Benefit obligation at end of year	80,267,273	69,739,738
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	49,347,927	45,945,024
Contributions	3,125,000	2,662,892
Actual return on plan assets	5,807,116	2,968,722
Benefits paid	(3,710,820)	(2,228,711)
Fair value of plan assets at end of year	54,569,223	49,347,927
Funded status of the plan	\$ (25,698,050)	\$ (20,391,811)
<b>Components of net periodic pension cost</b>		
Service cost	\$ 1,744,674	\$ 2,154,644
Interest cost	3,984,156	4,042,228
Expected return on plan assets	(3,984,361)	(3,665,290)
Net amortization and deferral	1,135,436	187,401
Curtailment loss	-	576,155
Net periodic pension cost	\$ 2,879,905	\$ 3,295,138

The measurement date for determining plan assets and obligations is September 30.

The Milford Hospital, Incorporated  
Notes to Financial Statements (continued)

**6. Pension Plan (continued)**

The weighted-average assumptions used to develop net periodic benefit cost, and the projected benefit obligation as of September 30, 2010 and 2009, are as follows:

	<u>2010</u>	<u>2009</u>
Discount rate used for net periodic pension cost	<b>5.50%</b>	7.00%
Discount rate used for projected benefit obligation	<b>5.00</b>	5.50
Expected long-term rate of return on plan assets	<b>8.00</b>	8.00
Rate of compensation increase	<b>3.50</b>	6.00

To develop the expected long-term rate of return on plan assets assumption, the Hospital considered the historical return and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

Assets invested in the defined benefit cash balance plan are carried at fair value. Debt securities and equity securities with readily determinable values are carried at fair value as determined based on independent published sources.

The accumulated benefit obligation at September 30, 2010 and 2009 was \$72,601,273 and \$64,548,878, respectively.

**Plan Assets**

The Plan's investment objectives are to achieve long-term growth in excess of long-term inflation, and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets over a long-term time horizon. In order to minimize the risk, the Plan aims to minimize the variability in yearly returns. The Plan also aims to diversify its holdings among sectors, industries, and companies. No more than 10% of the Plan's portfolio, excluding U.S. government securities and cash, may be held in an individual company's stocks or bonds, and no more than 20% in a single industry.

## The Milford Hospital, Incorporated

### Notes to Financial Statements (continued)

#### 6. Pension Plan (continued)

The Hospital's pension plan weighted-average allocations at September 30, 2010 and 2009, by asset category, are as follows:

<b>Asset Category</b>	<b>2010</b>	<b>2009</b>
Cash and money market funds	<b>5.5%</b>	7.2%
Corporate/Government bonds	<b>25.7</b>	40.7
Common equities	<b>68.8</b>	52.1
Total	<b>100.0%</b>	100.0%

The target allocation for the Plan's assets is 65% equity securities, 25% fixed income securities, and 10% other investments.

The plan's assets carried at fair value as of September 30, 2010 are classified in the table below in one of the three categories (as described in Note 4):

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Cash and money market funds	\$ 2,833,047	\$ –	\$ –	\$ 2,833,047
U.S. Treasury issues	–	–	–	–
Corporate debt securities	14,060,794	–	–	14,060,794
Equity securities	35,815,946	–	1,859,436	37,675,382
Total	\$ 52,709,787	\$ –	\$ 1,859,436	\$ 54,569,223

The changes in investments classified as Level 3 are as follows for the year ended September 30, 2010:

Beginning balance for the year	\$ –
Purchases, sales and settlements, net	1,717,385
Net change in unrealized appreciation	142,051
Ending balance for the year	\$ 1,859,436

#### Contributions

The Hospital expects to contribute \$2,800,000 to the Plan in 2011.

The Milford Hospital, Incorporated  
Notes to Financial Statements (continued)

**6. Pension Plan (continued)**

**Estimated Future Benefit Payments**

Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

<b>Fiscal Years</b>	
2011	\$ 2,826,467
2012	2,922,082
2013	3,227,976
2014	3,470,471
2015	3,572,693
Years 2016 – 2020	20,417,034

**7. Transactions With Affiliates**

Amounts expected to be collected from affiliated entities are as follows:

	<b>September 30</b>	
	<b>2010</b>	<b>2009</b>
Milford Medical Lab, Inc.	<b>\$ 315,337</b>	\$ 228,387
Milford Health and Medical, Inc.	<b>275,113</b>	254,111
Home Care Plus, Inc.	<b>16,849</b>	21,225
Other affiliated entities	<b>112,314</b>	73,803
	<b><u>\$ 719,613</u></b>	<b><u>\$ 577,526</u></b>

Amounts due from Milford Medical Lab, Inc. relate to lab and related services provided by the Hospital on behalf of Milford Medical Lab, Inc. The Hospital charged Milford Medical Lab, Inc. \$630,488 and \$677,033 in 2010 and 2009, respectively, for those services. The receivable from Milford Medical Lab, Inc. is net of an allowance for uncollectible accounts of \$7,329,886 and \$6,826,969 at September 30, 2010 and 2009, respectively.

Amounts due from Milford Health and Medical, Inc., Home Care Plus, Inc., and other affiliated entities are the result of allocating joint general and administrative costs incurred by the Hospital. The amounts allocated to affiliates during the years ended September 30, 2010 and 2009 were \$76,726 and \$124,028, respectively.

# The Milford Hospital, Incorporated

## Notes to Financial Statements (continued)

### 7. Transactions With Affiliates (continued)

During 2003, the Hospital entered into a mortgage loan agreement with Torry Corporation. The loan is payable over 30 years, and bears interest at 6.0%. Torry Corporation paid off this loan November 17, 2009 in conjunction with entering into a new construction loan with the bank. At September 30, 2009, the amount outstanding under this agreement was \$642,750.

### 8. Medical Malpractice Insurance

Effective October 1, 2004, the Hospital became insured by the Parent through Healthcare Alliance Insurance Company, Ltd. (HAIC). HAIC is a multi-provider captive insurance company domiciled in the Cayman Islands. The Parent is a one-third owner of the captive with two other local hospitals that each hold one-third ownership. The Hospital's insurance coverage is \$1,500,000 per occurrence, and \$3,000,000 in the aggregate. The Hospital has an excess layer of indemnity coverage of \$25,000,000 per occurrence, and \$25,000,000 in the aggregate.

Management accrues its best estimate of losses as they occur. Accordingly, management has recorded a liability of \$478,000 and \$528,000 at September 30, 2010 and 2009, respectively, for claims incurred-but-not-reported. This liability has been discounted using a 5% and 4% discount rate at September 30, 2010 and 2009, respectively.

### 9. Commitments and Contingencies

The Hospital is a party to various lawsuits incidental to its business. Management believes that the lawsuits fall within the Hospital's liability insurance, and that they will not have a material adverse effect on the Hospital's financial statements.

### 10. Functional Expenses

The Hospital provides inpatient and outpatient general healthcare services to residents within its geographic location. Expenses related to providing these services are as follows:

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
Healthcare services	<b>\$ 74,710,549</b>	\$ 76,345,739
General and administrative	<b>11,337,189</b>	12,141,734
	<b><u>\$ 86,047,738</u></b>	<b><u>\$ 88,487,473</u></b>

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