

**Lawrence & Memorial Hospital**  
**Consolidated Financial Statements**  
**September 30, 2011 and 2010**

**Lawrence & Memorial Hospital**  
**Index**  
**September 30, 2011 and 2010**

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## Report of Independent Auditors

To the Board of Trustees of  
Lawrence & Memorial Hospital

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in net assets, and cash flows present fairly, in all material respects, the financial position of Lawrence & Memorial Hospital (a subsidiary of Lawrence & Memorial Corporation, the "Hospital") at September 30, 2011 and 2010, and the results of their operations, their changes in net assets, and of their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated 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 of these statements 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information, on pages 24 through 29, 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 organizations. Accordingly, we do not express an opinion on the financial position, results of operations, and changes in net assets, of the individual organizations. However, the consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, based on our audits is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

*PricewaterhouseCoopers LLP*

December 16, 2011

**Lawrence & Memorial Hospital**  
**Consolidated Balance Sheets**  
**September 30, 2011 and 2010**

	2011	2010
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 41,797,328	\$ 33,160,240
Investments	105,904,042	106,795,008
Patient accounts receivable, net of allowance for doubtful accounts of \$6,727,011 and \$6,760,213, respectively	30,483,331	30,942,261
Other receivables	3,998,458	5,765,211
Inventories	4,528,017	3,796,086
Due from affiliates	578,161	6,243,476
Prepaid expenses and other current assets	1,739,804	1,624,613
Debt service fund	1,109,892	1,248,032
Total current assets	190,139,033	189,574,927
Assets limited as to use		
Cash	179,900	179,215
Construction fund	8,427,695	-
Investments held in trust	11,241,951	11,986,573
Endowment investments	14,398,888	14,741,092
Funds held in trust by others	5,607,933	5,876,049
Contributions receivable	20,328	46,092
Funds held in escrow by agreement with State of Connecticut Health and Educational Facilities Authority and trustees	2,247,370	7,156,167
Total assets limited as to use	42,124,065	39,985,188
Deferred financing costs and other assets, net	1,938,833	1,330,365
Property, plant and equipment, net	120,976,861	109,171,111
	\$ 355,178,792	\$ 340,061,591
<b>Liabilities and Net Assets</b>		
Current liabilities		
Accounts payable	\$ 22,690,113	\$ 19,524,046
Accrued vacation and sick pay	11,705,811	11,220,455
Salaries, wages, payroll taxes and amounts withheld from employees	3,125,898	5,023,219
Due to affiliates	1,913,991	4,764,147
Due to third party payors	7,838,088	8,559,110
Current portion of long-term debt	2,976,493	2,866,493
Total current liabilities	50,250,394	51,957,470
Accrued pension and other postretirement benefits	43,423,221	52,131,286
Other liabilities	14,213,720	12,279,482
Long-term debt, less current portion	82,249,920	61,883,130
Total liabilities	190,137,255	178,251,368
Net assets		
Unrestricted	141,738,900	137,908,558
Temporarily restricted	17,792,779	18,251,340
Permanently restricted	5,509,858	5,650,325
Total net assets	165,041,537	161,810,223
	\$ 355,178,792	\$ 340,061,591

The accompanying notes are an integral part of these consolidated financial statements.

**Lawrence & Memorial Hospital**  
**Consolidated Statements of Operations**  
**Years Ended September 30, 2011 and 2010**

	2011	2010
<b>Unrestricted revenues, gains and other support</b>		
Net revenues from services to patients	\$ 325,275,690	\$ 314,168,301
Other operating revenues	11,091,202	9,926,307
Net assets released from restriction used for operations	394,829	412,940
Total unrestricted revenues, gains and other support	<u>336,761,721</u>	<u>324,507,548</u>
<b>Expenses</b>		
Salaries and wages	149,953,412	143,999,074
Employee benefits	41,985,784	40,325,006
Supplies	45,904,757	43,164,547
Purchased services	23,474,674	21,093,240
Other	29,046,249	29,171,055
Interest	2,212,181	2,332,245
Depreciation and amortization	17,199,566	16,728,407
Bad debts	14,356,474	15,052,335
Total expenses	<u>324,133,097</u>	<u>311,865,909</u>
Income from operations	12,628,624	12,641,639
Nonoperating gains		
Unrestricted investment income	171,387	175,335
Income/(loss) from investments	5,993,369	2,341,396
Loss on refinancing of debt	(2,026,984)	-
Total nonoperating gains (losses)	<u>4,137,772</u>	<u>2,516,731</u>
Excess of revenues over expenses	16,766,396	15,158,370
Transfers to affiliated entity	(12,670,075)	(4,900,000)
Net unrealized (losses)/gains on investments	(6,282,024)	5,459,058
Net assets released from restriction used for purchase of property, plant and equipment	176,082	181,470
Pension - related changes other than periodic pension costs	5,839,963	(7,611,564)
Increase/(decrease) in unrestricted net assets	<u>\$ 3,830,342</u>	<u>\$ 8,287,334</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Lawrence & Memorial Hospital**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended September 30, 2011 and 2010**

	2011	2010
<b>Unrestricted net assets</b>		
Excess of revenues over expenses	\$ 16,766,396	\$ 15,158,370
Transfer (to)/from affiliated entities	(12,670,075)	(4,900,000)
Net unrealized (losses)/gains on investments	(6,282,024)	5,459,058
Net assets released from restrictions used for purchase of property, plant and equipment	176,082	181,470
Pension - related changes other than periodic pension costs	5,839,963	(7,611,564)
Increase/(decrease) in unrestricted net assets	<u>3,830,342</u>	<u>8,287,334</u>
Beginning of year unrestricted net assets	<u>137,908,558</u>	<u>129,621,224</u>
End of year unrestricted net assets	<u>\$ 141,738,900</u>	<u>\$ 137,908,558</u>
<b>Temporarily restricted net assets</b>		
Income from investments	\$ 321,776	\$ 268,083
Net assets released from restrictions	(570,911)	(594,410)
Contributions received	229,693	191,238
Change in value of irrevocable trust	(152,473)	159,705
Net realized and unrealized (losses)/gains on investments	<u>(286,646)</u>	<u>1,014,887</u>
(Decrease)/Increase in temporarily restricted net assets	(458,561)	1,039,503
Beginning of year temporarily restricted net assets	<u>18,251,340</u>	<u>17,211,837</u>
End of year temporarily restricted net assets	<u>\$ 17,792,779</u>	<u>\$ 18,251,340</u>
<b>Permanently restricted net assets</b>		
Change in value of funds held in trust by others	<u>\$ (140,467)</u>	<u>\$ 105,212</u>
(Decrease)/increase in permanently restricted net assets	(140,467)	105,212
Beginning of year permanently restricted net assets	<u>5,650,325</u>	<u>5,545,113</u>
End of year permanently restricted net assets	<u>\$ 5,509,858</u>	<u>\$ 5,650,325</u>
Increase/(decrease) in net assets	<u>\$ 3,231,314</u>	<u>\$ 9,432,049</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Lawrence & Memorial Hospital**  
**Consolidated Statements of Cash Flows**  
**Years Ended September 30, 2011 and 2010**

	2011	2010
<b>Cash flows from operating activities</b>		
Change in net assets	\$ 3,231,314	\$ 9,432,049
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	17,199,566	16,728,407
Receipt of contributed securities	(169,303)	(427,788)
Net unrealized and realized losses/(gain) on investments	7,312,953	(6,340,835)
Provision for bad debts	14,356,474	15,052,335
Decrease/(increase) in funds held in trust by others	268,116	(264,481)
Decrease in contributions receivable	25,764	2,377
Changes in other operating accounts		
Patient accounts receivable, net	(13,897,544)	(15,940,192)
Other receivables, net	1,766,753	230,025
Inventories	(731,931)	(289,973)
Due from affiliates	5,665,315	(3,340,320)
Prepaid expenses and other current assets	(115,191)	687,966
Deferred financing costs and other assets	(608,468)	87,927
Accounts payable	3,283,709	4,355,867
Accrued vacation and sick pay	485,356	579,004
Salaries, wages, payroll taxes and amounts withheld from employees	(1,897,321)	838,886
Due to affiliates	(2,850,156)	3,081,437
Due to third party payors	(721,022)	(530,328)
Pension, postretirement and other liabilities	(6,773,827)	9,178,968
Net cash provided by operating activities	<u>25,830,557</u>	<u>33,121,331</u>
<b>Cash flows from investing activities</b>		
Purchase of property, plant and equipment, net	(29,122,958)	(19,933,142)
Purchase of investments	(81,028,014)	(94,425,145)
Sales of investments	67,264,473	93,311,452
Decrease/(increase) in debt service fund	138,140	47,062
Income from temporarily and permanently restricted investments	169,303	427,788
Decrease in funds held in escrow	4,908,797	3,443
Net cash used in investing activities	<u>(37,670,259)</u>	<u>(20,568,542)</u>
<b>Cash flows from financing activities</b>		
Principal payments of long term debt	(2,926,158)	(2,262,462)
Proceeds of long term debt	23,402,948	-
Net cash provided by/(used in) financing activities	<u>20,476,790</u>	<u>(2,262,462)</u>
Net increase in cash and cash equivalents	8,637,088	10,290,327
<b>Cash and cash equivalents</b>		
Beginning of year	33,160,240	22,869,913
End of year	<u>\$ 41,797,328</u>	<u>\$ 33,160,240</u>
<b>Supplemental disclosure of noncash activities</b>		
Construction in process included in accounts payable	\$ 1,644,565	\$ 1,526,923
Contributed securities	<u>\$ 169,303</u>	<u>\$ 427,788</u>

The accompanying notes are an integral part of these consolidated financial statements.

# Lawrence & Memorial Hospital

## Notes to Consolidated Financial Statements

### September 30, 2011 and 2010

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#### 1. Significant Accounting Policies and Organization

##### **Organization**

Lawrence & Memorial Hospital (the "Hospital"), a nonprofit organization incorporated under the General Statutes of the State of Connecticut, is a wholly-owned subsidiary of Lawrence & Memorial Corporation (the "Corporation"). The Board of the Corporation elects a Board of Directors who manages the property and affairs of the Hospital.

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

The consolidated financial statements include the accounts of the Hospital and its wholly owned subsidiary, Associated Specialists of Southeastern Connecticut, Inc. ("Associated Specialists"). All intercompany accounts and transactions have been eliminated in consolidation.

##### **Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying footnotes. Actual results could differ from those estimates and there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Hospital's significant estimates include the collectibility of patient accounts receivable, useful lives of fixed assets, estimated settlements due to third party payors, estimated reserves for self-insurance liabilities, and benefit plan assumptions.

##### **Regulatory Matters**

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

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

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time frame or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital and its subsidiary in perpetuity or in funds held in trust by others whose purpose is for the funds to be maintained in perpetuity.

##### **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 support 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 to unrestricted net assets and reported in the consolidated statement of operations as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions in the accompanying consolidated statement of operations.

##### **Cash and Cash Equivalents**

The Hospital and its subsidiary consider all highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents.

# Lawrence & Memorial Hospital

## Notes to Consolidated Financial Statements

### September 30, 2011 and 2010

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#### **Investments**

Investments in equity and debt securities are recorded at fair value in the balance sheet. Fair value is generally determined based on quoted market prices. 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 included in the change in net assets.

Realized and unrealized gains and losses on donor restricted endowment funds are included in temporarily restricted net assets under State law which allows the Board to appropriate as much of the net appreciation of investments as is prudent considering the Hospital's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends and general economic conditions.

Investments in limited liability companies are accounted for using the equity method in instances where the limited partner's interest is more than minor (3-5%).

#### **Fair Value Measurements**

Fair value guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entities own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the Hospital for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

- Level 1 – Quoted prices in active markets for identical assets.
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets in active markets, quoted prices in markets that are not active, or can be corroborated by observable market data for substantially the same term of the assets.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets.

#### **Assets Held in Trust by Others**

The Hospital has been named sole or participating beneficiary in several perpetual and charitable remainder trusts. Under the terms of these trusts, the Hospital has the irrevocable right to receive the income earned on the trust assets in perpetuity from the perpetual trusts and to receive the remainder of the trust assets for the charitable remainder trusts. For perpetual trusts, the estimated present value of the future payments to the Hospital is recorded at the fair value of the assets held in the trust. The charitable remainder trusts are recorded at the present value of the estimated future distributions expected to be received over the expected term of the trust agreement. The Hospital uses appropriate credit adjusted rates.

# **Lawrence & Memorial Hospital**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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

Assets limited as to use include assets set aside by the Board of Directors to fund the deductible portion of malpractice insurance coverage (maintained in an irrevocable trust), contribution receivables and for the established purpose of providing for future improvement, expansion and replacement of plant and equipment. In addition, funds held in trust by others, unexpended bond proceeds for construction purposes, and assets held by trustees under indenture agreements relating to financing activities with the State of Connecticut Health and Education Facilities Authority ("CHEFA") are also included therein.

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

Property, plant and equipment are recorded at cost, or, if received as a donation, at the fair value on the date received. The Hospital provides for depreciation of property, plant and equipment using the straight-line method in amounts sufficient to amortize the cost of its assets over their useful lives. American Hospital Association lives are generally used and provide for a 2-25 year life for land improvements, 5-50 year life for buildings and 2-25 year life for equipment. Lease improvements are amortized over the life of the lease.

#### **Non-Operating Gains and Losses**

Activities other than in connection with providing health care services are considered to be non-operating.

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

The consolidated statement of operations includes excess of revenues over expenses. Changes in unrestricted net assets which are excluded from the excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, 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 pension-related charges other than periodic pension costs and other postretirement benefits liabilities.

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

Certain investments and other assets and liabilities are carried at amounts that approximate fair value based on current market conditions. The fair value of long-term debt is estimated based on the quoted market prices for the same or similar issues or on current rates offered to the Hospital for debt of the same remaining maturities.

#### **Benefit Plans**

The Hospital has a defined benefit plan and a defined contribution plan (see Note 8).

#### **Medical Malpractice Self-Insurance**

The Hospital purchases occurrence-based professional and general liability insurance to cover medical malpractice claims. The Hospital has adopted the policy of self-insuring the deductible portion of its malpractice insurance coverage up to certain per claim and aggregate limits. The Hospital has established an irrevocable trust for the purpose of setting aside assets which can only be used for the payment of malpractice losses, related expenses, and the cost of administering the trust. Management accrues its best estimate of losses as incidents which give rise to potential losses occur.

#### **Income Taxes**

The Hospital and its wholly owned subsidiary, Associated Specialists are not-for-profit organizations and are exempt from federal income taxes on related income under Section 501(c)(3) of the Internal Revenue Code.

**Lawrence & Memorial Hospital**  
**Notes to Consolidated Financial Statements**  
**September 30, 2011 and 2010**

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**Inventories**

Inventory consists of supplies, both medical and general pharmaceuticals and food products needed to sustain daily operation of patient care. Inventories are carried at the lower of cost or market under the first-in-first-out (FIFO) method.

**Impairment of Long-Lived Assets**

Long-lived assets to be held and used are reviewed for impairment whenever circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to dispose.

**Accrued Vacation and Sick Pay**

Accrued vacation is recorded as a liability as time is earned. As the time is used, the time is relieved from the liability. Accrued sick time is recorded as a percent for employees who have a balance greater than or equal to 800 hours. This payout is only upon termination of employment.

**Subsequent Events**

The Hospital has performed an evaluation of subsequent events through December 16, 2011, which is the date the financial statements were issued.

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

The following summarizes net revenues from services to patients:

	<b>2011</b>	<b>2010</b>
Gross charges from services to patients	\$ 666,081,059	\$ 651,382,509
Less: Charity care	6,368,501	5,279,619
Charges from services to patients, net of charity care	<u>659,712,558</u>	<u>646,102,890</u>
Deductions		
Allowances	336,363,800	333,840,923
State of Connecticut uncompensated care system (receipts)	<u>(1,926,932)</u>	<u>(1,906,334)</u>
Total deductions	<u>334,436,868</u>	<u>331,934,589</u>
Net revenues from services to patients	<u>\$ 325,275,690</u>	<u>\$ 314,168,301</u>

Patient accounts receivable and revenues are recorded when patient services are performed. Amounts received from most payors are different from established billing rates of the Hospital, and these differences are accounted for as allowances. The Hospital receives cash from the State of Connecticut Uncompensated Care Pool. The Hospital records this as an increase to their net revenues from services to patients.

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. Adjustments related to prior year settlements increased the Hospital's revenues by approximately \$3,852,000 and \$16,000 in 2011 and 2010, respectively.

**Lawrence & Memorial Hospital**  
**Notes to Consolidated Financial Statements**  
**September 30, 2011 and 2010**

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During 2011 and 2010, approximately 32% and 33%, respectively, of net patient service revenue was received under the Medicare program, and 12% and 10%, respectively, under the state Medicaid program. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. 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. While no regulatory inquiries have been made, 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 reductions of funding levels could have an adverse impact on the Hospital.

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 federal poverty income guidelines, but also includes certain cases where incurred charges are significant when compared to income. These charges are not included in net patient service revenues for financial reporting purposes.

**3. Investments**

Investments at September 30 consist of:

	2011	2010
Pooled endowment funds		
Cash and cash equivalents	\$ 249,730	\$ 432,604
Bonds	2,593,730	2,259,321
Hedge funds	3,885,010	3,527,534
Marketable equities	7,670,418	8,521,633
Total pooled endowment funds	<u>14,398,888</u>	<u>14,741,092</u>
Investments held in trust by others		
Cash and cash equivalents	140,077	168,922
Bonds	2,814,055	1,949,338
Marketable equities	2,389,834	3,580,952
Other investments	263,967	176,837
Total investments held in trust by others	<u>5,607,933</u>	<u>5,876,049</u>
Other investments		
Cash and cash equivalents	1,225,923	842,700
Bonds	23,780,506	25,490,811
Hedge funds	38,440,365	36,420,934
Equity investments	14,117	13,681
Marketable equities	42,443,131	44,026,882
Total other investments	<u>105,904,042</u>	<u>106,795,008</u>
	<u>\$ 125,910,863</u>	<u>\$ 127,412,149</u>

The Hospital's financial instrument categorization is based upon the lowest level of input that is significant to the fair value measurement within the valuation hierarchy. The following table presents the financial instruments carried at fair value using the valuation hierarchy:

**Lawrence & Memorial Hospital**  
**Notes to Consolidated Financial Statements**  
**September 30, 2011 and 2010**

	<b>2011</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Fair Value</b>
<b>Pooled endowment funds</b>				
Cash and cash equivalents	\$ 249,730	\$ -	\$ -	\$ 249,730
Bonds	2,593,731	-	-	2,593,731
Hedge funds	-	-	3,885,010	3,885,010
Marketable equities	7,670,418	-	-	7,670,418
Total pooled endowment funds	<u>10,513,879</u>	<u>-</u>	<u>3,885,010</u>	<u>14,398,889</u>
<b>Held in trust by others</b>				
Cash and cash equivalents	-	-	140,077	140,077
Bonds	-	-	2,814,054	2,814,054
Marketable equities	-	-	2,653,801	2,653,801
Total held in trust by others	<u>-</u>	<u>-</u>	<u>5,607,932</u>	<u>5,607,932</u>
<b>Other investments</b>				
Cash and cash equivalents	1,225,923	-	-	1,225,923
Bonds	23,780,506	-	-	23,780,506
Hedge funds	-	-	38,440,365	38,440,365
Marketable equities	42,443,131	-	-	42,443,131
Total other investments	<u>67,449,560</u>	<u>-</u>	<u>38,440,365</u>	<u>105,889,925</u>
	<u>\$ 77,963,439</u>	<u>\$ -</u>	<u>\$ 47,933,307</u>	<u>\$ 125,896,746</u>

	<b>2010</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Fair Value</b>
<b>Pooled endowment funds</b>				
Cash and cash equivalents	\$ 432,604	\$ -	\$ -	\$ 432,604
Bonds	115,698	2,143,623	-	2,259,321
Hedge funds	-	-	3,527,534	3,527,534
Marketable equities	5,300,337	3,221,296	-	8,521,633
Total pooled endowment funds	<u>5,848,639</u>	<u>5,364,919</u>	<u>3,527,534</u>	<u>14,741,092</u>
<b>Held in trust by others</b>				
Cash and cash equivalents	-	-	168,922	168,922
Bonds	-	-	1,949,338	1,949,338
Marketable equities	-	-	3,580,952	3,580,952
Other investments	-	-	176,837	176,837
Total held in trust by others	<u>-</u>	<u>-</u>	<u>5,876,049</u>	<u>5,876,049</u>
<b>Other investments</b>				
Cash and cash equivalents	842,700	-	-	842,700
Bonds	-	25,490,811	-	25,490,811
Hedge funds	-	-	36,420,934	36,420,934
Marketable equities	20,965,635	23,061,247	-	44,026,882
Total other investments	<u>21,808,335</u>	<u>48,552,058</u>	<u>36,420,934</u>	<u>106,781,327</u>
	<u>\$ 27,656,974</u>	<u>\$ 53,916,977</u>	<u>\$ 45,824,517</u>	<u>\$ 127,398,468</u>

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Fair value for Level 1 is based upon quoted prices in active markets that the Hospital has the ability to access at the measurement date. Market price data is generally obtained from exchange or dealer markets. The Hospital does not adjust the quoted price for such assets.

Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers and brokers.

Fair value for Level 3 is based on valuation techniques that use significant inputs that are unobservable as they trade infrequently or not at all and reflect assumptions based on the best information available in the circumstances.

Investments included in Level 3 primarily consist of the Hospital's ownership in alternative investments (principally limited partnership interests in hedge funds). The value of these alternative investments represents the ownership interest in the net asset value ("NAV") of the respective partnership. The fair values of the securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner and are based on appraisals, or other estimates that require varying degrees of judgment. If no public market exists for the investment securities, the fair value is determined by the general partner taking into consideration, among other things, the cost of the securities, prices of recent significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate. Also included in Level 3 investments are charitable remainder trusts held by third parties which are recorded at the present value of the future distributions expected to be received over the term of the agreement.

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 Hospital 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 estimate of fair value at the reporting date.

The following table is a roll forward of the amounts by investment type for financial instruments classified by the Hospital within Level 3 of the fair value hierarchy defined above:

	Beginning October 1, 2010	Investment Income	Realized Gains	Unrealized Losses	Investment Fees	Net Purchases	Ending September 30, 2011
Investment pool							
Hedge funds	\$ 39,948,468	\$ 274,823	\$ 290,825	\$ (158,547)	\$ (99,615)	\$ 2,069,421	\$ 42,325,375
Funds held in trust	5,876,049	-	-	(268,117)	-	-	5,607,932
Total	<u>\$ 45,824,517</u>	<u>\$ 274,823</u>	<u>\$ 290,825</u>	<u>\$ (426,664)</u>	<u>\$ (99,615)</u>	<u>\$ 2,069,421</u>	<u>\$ 47,933,307</u>

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	Beginning October 1, 2009	Investment Income	Realized Gains	Unrealized Losses	Investment Fees	Net Purchases	Ending September 30, 2010
Investment pool							
Hedge funds	\$ 19,767,355	\$ 161,672	\$ 115,119	\$ 1,692,231	\$ (63,366)	\$ 18,275,457	\$ 39,948,468
Funds held in trust	5,611,568	-	-	264,481	-	-	5,876,049
Total	<u>\$ 25,378,923</u>	<u>\$ 161,672</u>	<u>\$ 115,119</u>	<u>\$ 1,956,712</u>	<u>\$ (63,366)</u>	<u>\$ 18,275,457</u>	<u>\$ 45,824,517</u>

A summary of the pooled endowment investment return is presented below:

	2011	2010
Investment income	\$ 304,147	\$ 267,855
Realized and unrealized (losses)/gains	(286,648)	1,014,886
Management fees and other costs	(35,237)	(40,275)
Total return on pooled endowment investments	<u>\$ (17,738)</u>	<u>\$ 1,242,466</u>

Following is additional information related to funds whose fair value is not readily determinable as of September 30, 2011.

	Strategy	Fair Value	# of Investments	Remaining Life	\$ Amount of Unfunded Commitments	Timing to Draw Down Commitments	Redemption Terms	Redemption Restrictions	Restrictions in Place at Year End
Equity securities	Global developed and emerging market equity	\$ 8,406,169	1	N/A	-	No remaining commitments	Monthly with 10 day's notice		None
Absolute return	Long/short and long-biased equity and credit hedge funds	12,195,388	1	N/A	-	No remaining commitments	Annual with 90 day's notice	lock up provision of 12 months from the purchase date	None
Directional hedge	Long/short and long-biased equity and credit hedge funds	17,415,554	1	N/A	-	No remaining commitments	Quarterly with 60 day's notice	lock up provision c 25 months from the purchase date	None
Commodities	Commodity index	4,228,264	1	N/A	-	No remaining commitments	Monthly with 5 day's notice		None
Private Equity	Private equity	80,000	1	N/A	-	Illiquid long term 5 years	None	None	None
		\$ 42,325,375							

**4. Endowments**

The Hospital's endowment consists of donor restricted endowment funds for a variety of purposes. The net assets associated with endowment funds including funds designated by the Board of Directors to function as endowments are classified and reported based on the existence or absence of donor imposed restrictions.

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The Hospital understands net asset classification guidance requires that donor restricted endowment gifts be maintained in perpetuity. Consistent with net asset classification guidance, the Hospital classified 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. The Hospital considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund
- The purposes of the Hospital and 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 Hospital
- The investment policies of the Hospital

Changes in endowment net assets for year ended September 30:

	<b>2011</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	
Endowment net assets, beginning of year	\$ -	\$ 12,134,604	\$ 2,839,683	\$ 14,974,287
Investment return				
Investment income	-	114,203	-	114,203
Net realized and unrealized (losses)/gains	-	(286,646)	-	(286,646)
Total investment return	-	(172,443)	-	(172,443)
Income distribution	-	(173,182)	-	(173,182)
Endowment net assets, end of year	\$ -	\$ 11,788,979	\$ 2,839,683	\$ 14,628,662

	<b>2010</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	
Endowment net assets, beginning of year	\$ -	\$ 11,222,301	\$ 2,839,683	\$ 14,061,984
Investment return				
Investment income	-	55,426	-	55,426
Net realized and unrealized gain/(losses)	-	1,014,887	-	1,014,887
Total investment return	-	1,070,313	-	1,070,313
Income distribution	-	(158,010)	-	(158,010)
Endowment net assets, end of year	\$ -	\$ 12,134,604	\$ 2,839,683	\$ 14,974,287

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The portion of perpetual endowment funds retained permanently either by explicit donor stipulation or by net asset classification guidance is summarized as follows:

	2011	2010
<b>Temporarily restricted net assets</b>		
Unspent income and appreciation on permanently restricted endowments for purchase of equipment and healthcare services	\$ 11,788,979	\$ 12,134,604
Total endowment funds classified as Temporarily restricted net assets	<u>\$ 11,788,979</u>	<u>\$ 12,134,604</u>
<b>Permanently restricted net assets</b>		
Corpus of permanently restricted contributions for purchase of equipment and healthcare services	\$ 2,839,683	\$ 2,839,683
Total endowment funds classified as permanently restricted net assets	<u>\$ 2,839,683</u>	<u>\$ 2,839,683</u>

**Endowment Funds with Deficits**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist they are classified as a reduction of unrestricted net assets.

**Endowment Investment Return Objectives and Risk Parameters**

The Hospital has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by the endowment while seeking to maintain the permanent nature of endowment funds. Under this policy, the return objective for the endowment assets measured over a full market cycle shall be to maximize the return against a blended index, based on the endowment's target asset allocation applied to the appropriate individual benchmarks.

**Strategies Employed for Achieving Endowment Investment Objectives**

To achieve its long-term rate of return objectives, the Hospital relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The Hospital targets a diversified asset allocation to achieve its long-term objectives within prudent Hospital risk constraints.

**Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives**

Spending is guided by several factors most important is the value of the portfolio. Generally, the Board will approve a spending policy limiting annual expenditures for grants and operating expenses up to 4.5% of the value of the Funds' assets based on a 12 quarter rolling average for the endowment, Kitchings and operating funds. The Hospital will designate the spending amount on an as-needed basis for the special account.

Investment managers are given ample notice of the required withdrawal schedule. Appropriate liquidity is maintained to fund these withdrawals without impairing the investment process.

**5. Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes at September 30:

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	<b>2011</b>	<b>2010</b>
Funds held in trust by others	\$ 2,959,565	\$ 3,086,274
Contributions receivable	20,328	46,092
Free beds and plant replacement and expansion	11,788,979	12,134,604
Specific purpose reserves	<u>3,023,907</u>	<u>2,984,370</u>
	<u>\$ 17,792,779</u>	<u>\$ 18,251,340</u>

Permanently restricted net assets at September 30 are restricted to:

	<b>2011</b>	<b>2010</b>
Funds held in trust by others	\$ 2,670,175	\$ 2,810,642
Donor restricted endowment funds	<u>2,839,683</u>	<u>2,839,683</u>
	<u>\$ 5,509,858</u>	<u>\$ 5,650,325</u>

**6. Property, Plant and Equipment**

Property, plant and equipment consists of the following:

	<b>2011</b>	<b>2010</b>
Land and land improvements	\$ 6,506,216	\$ 5,212,649
Buildings	111,446,370	107,593,741
Equipment	<u>203,329,727</u>	<u>180,454,333</u>
	321,282,313	293,260,723
Less: Accumulated depreciation	<u>(210,414,909)</u>	<u>(193,724,896)</u>
	110,867,404	99,535,827
Construction in progress (estimated cost to complete at September 30, 2011 is \$14,873,263(unaudited))	<u>10,109,457</u>	<u>9,635,284</u>
	<u>\$ 120,976,861</u>	<u>\$ 109,171,111</u>

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**7. Long-Term Debt**

	<b>2011</b>	<b>2010</b>
CHEFA Series F Revenue Bonds		
Various rate bonds, due 2012 to 2026	\$ 39,135,000	-
5.0% Term Bonds, due 2027 to 2031	8,705,000	-
5.0% Term Bonds, due 2032 to 2036	11,100,000	-
CHEFA Series D revenue bonds		
5.0% Term bonds, due 2009 to 2013	-	8,750,000
5.0% Term bonds, due 2014 to 2022	-	33,870,000
CHEFA Series E revenue bonds		
Variable rate bonds, due 2023-2034	22,990,000	22,990,000
Capital lease obligation	405,373	377,538
Total long-term debt outstanding	<u>82,335,373</u>	<u>65,987,538</u>
Less: Amounts classified as current	2,976,493	2,866,493
Less: Bond discount	-	1,237,916
Add: Bond Premium	2,891,040	-
Total long-term portion of long-term debt	<u>\$ 82,249,920</u>	<u>\$ 61,883,129</u>

On September 15, 2011 CHEFA issued \$58,940,000 of Series F Bonds (the "Series F Bonds") on behalf of the Hospital and the Corporation (collectively referred to as the "Obligated Group" under the Series F Bond agreements). The Series F Bonds are structured with a term bond due July 1, 2036, with annual sinking fund payments due each July 1<sup>st</sup> commencing July 1, 2012. Interest on the Series F Bonds is payable semiannually on the first business day of January 1 and July 1 beginning January 1, 2012.

The proceeds of the Series F Bonds will be used to refund the outstanding Authority Revenue Bonds, Lawrence & Memorial Hospital Issue, Series D (the "Series D Bonds") and to fund all or a portion of the following capital projects: (i) replacement of a linear accelerator on the main campus of the Hospital; (ii) capital improvements for infrastructure renovation and improvement on the main campus, including heating, ventilation, and air conditioning project; (iii) replacement of a catheterization lab and equipment on the main campus; (iv) acquisition of approximately 100 acres of land in Waterford, Connecticut for development of a new cancer center; and (v) acquisition and installation of Magnetic Resonance Imaging ("MRI") and CT equipment at the Crossroads facility

On June 24, 2004 CHEFA issued \$22,990,000 of Series E Bonds (the "Series E Bonds") on behalf of the Hospital and Lawrence & Memorial Corporation (collectively referred to as the "Obligated Group" under the Series E Bond agreement). The Series E Bonds are structured with a term bond due July 1, 2034, with annual sinking fund payments due each July 1<sup>st</sup> commencing July 1, 2023. Interest on the Series E Bonds accrues at the weekly rate and is payable on the first business day of each month commencing July 1, 2004.

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The proceeds of the Series E Bonds were used to finance the acquisition, construction, capital improvements, renovation, and/or equipping of the expansion of the Hospital's Pequot Health Center, including a new 37,000 square foot building addition to house an ambulatory surgery unit, MRI series, and mobile medical technologies. The proceeds were also used to fund the debt service reserve fund and costs related to the issuance and interest related to the Series E Bonds. Under the terms of the trust indenture for the Series E Bonds, the Obligated Group is required to meet certain financial covenants including a debt service coverage ratio and days cash on hand ratio. Members of the Obligated Group are jointly and severally obligated to provide amounts sufficient to enable the Authority to pay principal and interest on the Series E Bonds. The Bonds and bond proceeds have been allocated to the Hospital and as such, the Hospital will make future debt service payments as required under the terms of the bonds.

The bonds may be retired at an earlier date pursuant to terms of the master indenture. Payment of the bonds is collateralized by a pledge of the gross receipts, as defined, and certain real property of the Hospital.

Effective January 16, 2008, the Hospital refinanced its CHEFA Series E bonds with JPMorgan Chase Bank, N.A. This reoffering does not update information contained in the original official statement but provides a new letter of credit, which expires in January 2013.

The Series E Bonds are considered variable rate demand bonds and are remarketed on a weekly basis. If the bonds are unable to be remarketed, the letter of credit could be utilized to purchase the bonds. The Obligated Group would then be subject to the payment terms of the letter of credit, which are equal quarterly installments beginning in the first quarter that is at least 367 days after the initial draw down on the letter of credit. The Series E Bonds have been successfully remarketed and there have been no draws on the letter of credit.

In accordance with the long-term loan agreement with CHEFA, certain trusteed funds are required to be maintained. These funds provide for debt service and other related payments. The income derived from these funds is required to be reinvested in the trusteed funds and is not available for current operating purposes.

The agreements will remain in force until principal and interest on the bonds and any other costs of the Authority with respect to the project have been fully paid or provided for. Annual payments due under the loan agreements include interest on the outstanding bonds.

The fair value of the Series E Bonds, using discounted cash flow analyses approximates carrying value at September 30, 2011 and 2010. The fair value of the Series D Bonds is approximately \$0 million and \$64.5 million as of September 30, 2011 and 2010, respectively.

Principal repayments on the CHEFA bonds are as follows:

Year	Annual Principal Repayment
2012	\$ 2,885,000
2013	2,625,000
2014	2,725,000
2015	2,835,000
2016 and thereafter	<u>70,860,000</u>
	<u>\$ 81,930,000</u>

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The Hospital made cash interest payments of \$2,178,800 and \$2,314,076 in fiscal year 2011 and 2010, respectively. No interest was capitalized during 2011 or 2010.

#### **8. Pension and Other Postretirement Benefits**

The Hospital has a defined benefit plan covering all employees who elected to stay in the plan. The plan is frozen to new participants as of June 30, 1999. The benefits are based on years of service and the employee's compensation during the last five years of employment. Assets of the plan include mutual funds, marketable equity securities, corporate and government bonds, notes and hedge funds. The investments have been selected to generate a return on the investments and protect the principal.

The Hospital provides health care and life insurance benefits to its retired employees who meet certain eligibility requirements. The Hospital's policy is to fund the cost of postretirement benefits other than pension as incurred. This plan was frozen to include only those employees who retired prior to May 1, 1994.

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The following table sets forth the plans' funded status and amounts recognized in the consolidated statement of financial position at September 30, 2011 and 2010 (measurement date of September 30):

	Pension Benefits		Other Postretirement Benefits	
	2011	2010	2011	2010
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year	\$ 131,200,922	\$ 117,330,146	\$ 1,277,520	\$ 1,290,578
Service cost	1,941,270	1,927,395	-	-
Interest cost	6,505,871	6,646,772	59,018	70,433
Employee contributions	163,401	180,479	-	-
Benefits paid	(5,255,985)	(5,267,983)	(120,183)	(130,095)
Actuarial (gain)/loss	(7,891,942)	10,384,113	(49,354)	46,604
Benefit obligation at end of year	<u>\$ 126,663,537</u>	<u>\$ 131,200,922</u>	<u>\$ 1,167,001</u>	<u>\$ 1,277,520</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	\$ 81,387,819	\$ 76,344,572	\$ -	\$ -
Actual return on plan assets	2,092,350	7,130,751	-	-
Employee contributions	163,401	180,479	-	-
Employer contributions	7,100,000	3,000,000	120,183	130,095
Benefits paid	(5,255,985)	(5,267,983)	(120,183)	(130,095)
Fair value of plan assets at end of year	<u>\$ 85,487,585</u>	<u>\$ 81,387,819</u>	<u>\$ -</u>	<u>\$ -</u>
Funded status of the plan	(41,175,952)	(49,813,103)	(1,167,001)	(1,277,520)
Unrecognized net loss/(gain) from past experience different from that assumed and effects of changes in assumptions	31,903,948	37,618,950	(526,034)	(531,764)
Unrecognized prior service cost	<u>471,588</u>	<u>596,549</u>	<u>-</u>	<u>-</u>
Accrued benefit costs recognized in the statement of financial position	<u>\$ (8,800,416)</u>	<u>\$ (11,597,604)</u>	<u>\$ (1,693,035)</u>	<u>\$ (1,809,284)</u>
<b>Components of net periodic benefit costs</b>				
Service cost	\$ 1,941,270	\$ 1,927,395	\$ -	\$ -
Interest cost	6,505,871	6,646,772	59,018	70,433
Expected return on plan assets	(6,850,835)	(6,350,382)	-	-
Amortization of net loss/(gain)	2,581,545	1,867,224	(55,084)	(61,546)
Net amortization and deferral	<u>124,961</u>	<u>124,956</u>	<u>-</u>	<u>-</u>
Benefit cost	<u>\$ 4,302,812</u>	<u>\$ 4,215,965</u>	<u>\$ 3,934</u>	<u>\$ 8,887</u>

The weighted average assumptions used to determine the net benefit cost at the beginning of the year are as follows:

	2011	2010
Discount rate	5.07%	5.80%
Average rate of compensation increases	4.25%	4.25%
Expected return on assets	8.50%	8.50%

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The weighted average assumptions used to determine the benefit obligation at the end of the year are as follows:

	<b>2011</b>	<b>2010</b>
Discount rate	5.34%	5.07%
Average rate of compensation increases	3.50%	4.25%

The Plan's asset allocations as of September 30, 2011 and 2010 are as follows:

<b>Asset Category</b>	<b>2011</b>	<b>2010</b>
Cash	5%	2%
Bonds	30%	24%
Hedge Funds	31%	30%
Marketable Equities	34%	44%
Total	100%	100%

The expected rate of return on assets is calculated based on past experience.

Expected benefits to be paid under the plans are as follows:

<b>Fiscal Years Beginning October 1</b>	<b>Expected Benefits</b>
2011	\$ 6,227,427
2012	6,509,958
2013	6,910,790
2014	7,155,303
2015	7,572,842
Expected Aggregate for 5 fiscal years beginning 2016	42,922,899

Annual contributions are determined by the Hospital based upon calculations prepared by the plan's actuary. Expected contributions to the Pension and Retiree Health Plan for 2012 are approximately:

Pension	\$ 6,509,958
Retiree Health	125,125

The weighted-average annual assumed rate of increase in the per capita cost of covered benefits (i.e., health care cost trend rate) for participants is assumed to be 9.0% in 2011 reducing to 5.0% by the year 2016 and remaining at that level thereafter. This health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, a one percentage point increase in the assumed health care cost trend rate would increase the accumulated post-retirement benefit obligation and service cost plus interest cost by approximately \$84,000 and \$94,000, respectively, at September 30, 2011 and 2010. A one percentage point decrease in the assumed health care cost trend rate would decrease the accumulated postretirement benefit obligation and service cost plus interest cost by approximately \$77,000 and \$86,000, respectively, at September 30, 2011 and 2010.

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**Plan Assets**

The defined benefit plan assets are valued utilizing the same fair value hierarchy as the Hospital's investments as described in Note 1.

The following table summarizes the fair values of investments by major type held by the staff pension plan at September 30, 2011:

	Level 1	Level 2	Level 3	2011
Investments, at fair value				
Cash	\$ 3,847,979	\$ -	\$ -	3,847,979
Bonds	25,779,769	-	-	25,779,769
Hedge Funds	-	-	26,524,387	26,524,387
Marketable Equities	<u>26,050,106</u>	<u>3,285,344</u>	<u>-</u>	<u>29,335,450</u>
Total investments, at fair value	<u>\$ 55,677,854</u>	<u>\$ 3,285,344</u>	<u>\$ 26,524,387</u>	<u>\$ 85,487,585</u>

The following table summarizes the fair values of investments by major type held by the staff pension health plan at September 30, 2010:

	Level 1	Level 2	Level 3	2010
Investments, at fair value				
Cash	\$ 1,873,724	\$ -	\$ -	\$ 1,873,724
Bonds	-	19,609,144	-	19,609,144
Hedge Funds	-	-	24,333,144	24,333,144
Marketable Equities	<u>14,103,283</u>	<u>21,468,524</u>	<u>-</u>	<u>35,571,807</u>
Total investments, at fair value	<u>\$ 15,977,007</u>	<u>\$ 41,077,668</u>	<u>\$ 24,333,144</u>	<u>\$ 81,387,819</u>

There were no transfers between levels comparing last to this year for assets that are in the portfolio.

The table below represents the change in fair value measurements for Level 3 investments held by the staff pension plans' year ended September 30, 2011 and 2010 respectively:

	2011	2010
Beginning Balance	\$ 24,333,144	\$ 19,719,016
Realized and unrealized gain, net	249,105	1,629,862
Purchases (sales), net	<u>1,942,138</u>	<u>2,984,266</u>
Ending Balance	<u>\$ 26,524,387</u>	<u>\$ 24,333,144</u>

The investment objective for the pension and post retirement plans seeks a positive long-term total return after inflation to meet the Hospital's current and future plan obligations.

Asset allocations for both plans combine tested theory and informed market judgment to balance investment risks with the need for high returns.

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The Hospital's 401(k) plan covers eligible employees who elect to participate in the plan. Eligible employees may contribute a percentage of their salary to the plan. The Hospital matches 100% of the first 4% of gross pay deferred by employees for those employees who do not participate in the defined benefit plan. Plan contributions charged to operations were approximately \$3,677,000 and \$3,628,000 for 2011 and 2010, respectively.

**9. Medical Malpractice Self-Insurance**

There have been malpractice claims that fall within the Hospital's self-insured program which have been asserted against the Hospital. In addition, there are known incidents that have occurred through September 30, 2011 that may result in the assertion of claims. The Hospital has engaged independent actuaries to estimate the ultimate cost of the settlement of such claims. Accrued malpractice losses have been discounted at 4% for 2011 and 5% for 2010. The Hospital maintains a trust to fund these liabilities on a long-term basis. As of October 1, 2011, the Hospital is insured for general liability and professional liability claims by L&M Indemnity Company, Ltd.. L&M Indemnity was established on September 28, 2011.

**10. Functional Expenses**

The Hospital provides general health care services to residents within its geographic location including pediatric care, cardiac catheterization, and outpatient surgery. Expenses by function are as follows:

	<b>2011</b>	<b>2010</b>
Health care services	\$ 246,193,019	\$ 239,228,653
General and administrative	77,940,078	72,637,256
	<u>\$ 324,133,097</u>	<u>\$ 311,865,909</u>

**11. Contingencies**

The Hospital is a party to various lawsuits incidental to its business. Management believes that the lawsuits will not have a material adverse effect on the Hospital's financial position, results of operations, changes in net assets or cash flows.

**Lawrence & Memorial Hospital**  
**Consolidating Balance Sheet**  
**September 30, 2011**

	Lawrence & Memorial Hospital	Associated Specialists of Connecticut	Eliminating Entities	Consolidated
<b>Assets</b>				
Current assets				
Cash	\$ 39,933,225	\$ 1,864,103	\$ -	\$ 41,797,328
Investments	105,904,042	-	-	105,904,042
Accounts receivable	29,920,862	562,469	-	30,483,331
Other receivables	3,881,712	116,746	-	3,998,458
Inventories	4,528,017	-	-	4,528,017
Due from affiliates	2,441,664	-	(1,863,503)	578,161
Prepaid expenses	1,739,804	-	-	1,739,804
Debt service fund	1,109,892	-	-	1,109,892
Total current assets	189,459,218	2,543,318	(1,863,503)	190,139,033
Assets limited as to use				
Cash	179,900	-	-	179,900
Construction funds	8,427,695	-	-	8,427,695
Investments held in trust	11,241,951	-	-	11,241,951
Endowment investments	14,398,888	-	-	14,398,888
Funds held in escrow	5,607,933	-	-	5,607,933
Contributions receivable	20,328	-	-	20,328
Debt Service fund	2,247,370	-	-	2,247,370
Total assets limited as to use	42,124,065	-	-	42,124,065
Other assets				
Deferred financing costs	1,938,833	-	-	1,938,833
Property, plant and equipment	120,976,861	-	-	120,976,861
Total assets	\$ 354,498,977	\$ 2,543,318	\$ (1,863,503)	\$ 355,178,792

**Lawrence & Memorial Hospital**  
**Consolidating Balance Sheet**  
**September 30, 2011**

	<b>Lawrence &amp; Memorial Hospital</b>	<b>Associated Specialists of Connecticut</b>	<b>Eliminating Entities</b>	<b>Consolidated</b>
<b>Liabilities</b>				
Current liabilities				
Accounts payable	\$ 22,689,860	\$ 253	\$ -	\$ 22,690,113
Accrued vacation and sick pay	10,661,313	1,044,498	-	11,705,811
Salaries, wages and payroll taxes	2,751,697	374,201	-	3,125,898
Due to affiliates	1,913,991	1,863,503	(1,863,503)	1,913,991
Due to third parties	7,838,088	-	-	7,838,088
Current portion of long-term debt	2,976,493	-	-	2,976,493
Total current liabilities	48,831,442	3,282,455	(1,863,503)	50,250,394
Accrued pension and other postretirement benefits	43,423,221	-	-	43,423,221
Other liabilities	14,213,720	-	-	14,213,720
Long-term debt, less current portion	82,249,920	-	-	82,249,920
Total liabilities	188,718,303	3,282,455	(1,863,503)	190,137,255
Net assets				
Unrestricted	142,478,037	(739,137)	-	141,738,900
Temporarily restricted	17,792,779	-	-	17,792,779
Permanently restricted	5,509,858	-	-	5,509,858
Total net assets	165,780,674	(739,137)	-	165,041,537
	\$ 354,498,977	\$ 2,543,318	\$ (1,863,503)	\$ 355,178,792

**Lawrence & Memorial Hospital**  
**Consolidating Balance Sheet**  
**September 30, 2010**

	Lawrence & Memorial Hospital	Associated Specialists of Connecticut	Eliminating Entities	Consolidated
<b>Assets</b>				
Current assets				
Cash	\$ 29,002,112	\$ 4,158,128	\$ -	\$ 33,160,240
Investments	106,795,008	-	-	106,795,008
Accounts receivable	29,686,477	1,255,784	-	30,942,261
Other receivables	5,607,525	157,686	-	5,765,211
Inventories	3,796,086	-	-	3,796,086
Due from affiliates	10,399,677	-	(4,156,201)	6,243,476
Prepaid expenses	1,624,613	-	-	1,624,613
Debt service fund	1,248,032	-	-	1,248,032
Total current assets	188,159,530	5,571,598	(4,156,201)	189,574,927
Assets limited as to use				
Cash	179,215	-	-	179,215
Construction funds	-	-	-	-
Investments held in trust	11,986,573	-	-	11,986,573
Endowment investments	14,741,092	-	-	14,741,092
Funds held in escrow	5,876,049	-	-	5,876,049
Contributions receivable	46,092	-	-	46,092
Debt Service fund	7,156,167	-	-	7,156,167
Total assets limited as to use	39,985,188	-	-	39,985,188
Other assets				
Deferred financing costs	1,330,365	-	-	1,330,365
Property, plant and equipment	109,171,111	-	-	109,171,111
Total assets	\$ 338,646,194	\$ 5,571,598	\$ (4,156,201)	\$ 340,061,591

**Lawrence & Memorial Hospital**  
**Consolidating Balance Sheet**  
**September 30, 2010**

	Lawrence & Memorial Hospital	Associated Specialists of Connecticut	Eliminating Entities	Consolidated
<b>Liabilities</b>				
Current liabilities				
Accounts payable	\$ 19,524,046	\$ -	\$ -	\$ 19,524,046
Accrued vacation and sick pay	10,275,147	945,308	-	11,220,455
Salaries, wages and payroll taxes	4,746,675	276,544	-	5,023,219
Due to affiliates	4,764,147	4,156,201	(4,156,201)	4,764,147
Due to third parties	8,559,110	-	-	8,559,110
Current portion of long-term debt	2,866,493	-	-	2,866,493
Total current liabilities	50,735,618	5,378,053	(4,156,201)	51,957,470
Accrued pension and other postretirement benefits	52,131,286	-	-	52,131,286
Other liabilities	12,279,482	-	-	12,279,482
Long-term debt, less current portion	61,883,130	-	-	61,883,130
Total liabilities	177,029,516	5,378,053	(4,156,201)	178,251,368
Net assets				
Unrestricted	137,717,053	191,505	-	137,908,558
Temporarily restricted	18,249,300	2,040	-	18,251,340
Permanently restricted	5,650,325	-	-	5,650,325
Total net assets	161,616,678	193,545	-	161,810,223
	\$ 338,646,194	\$ 5,571,598	\$ (4,156,201)	\$ 340,061,591

**Lawrence & Memorial Hospital**  
**Consolidating Statement of Operations**  
**September 30, 2011**

	<b>Lawrence &amp; Memorial Hospital</b>	<b>Associated Specialists of Connecticut</b>	<b>Eliminating Entities</b>	<b>Consolidated</b>
Net revenues	\$ 318,813,210	\$ 6,462,480	\$ -	\$ 325,275,690
Other operating revenues	15,662,907	33,290	(4,604,995)	11,091,202
Net assets released from restriction	394,829	-	-	394,829
	<u>334,870,946</u>	<u>6,495,770</u>	<u>(4,604,995)</u>	<u>336,761,721</u>
Operating expenses				
Salaries and wages	141,165,650	8,910,864	(123,102)	149,953,412
Employee benefits	41,723,413	1,535,471	(1,273,100)	41,985,784
Supplies	45,855,424	49,333		45,904,757
Purchased services	22,304,506	3,688,219	(2,518,051)	23,474,674
Other	28,005,159	1,731,832	(690,742)	29,046,249
Interest	2,212,181	-	-	2,212,181
Depreciation and amortization	17,199,566	-	-	17,199,566
Bad debts	13,865,210	491,264	-	14,356,474
	<u>312,331,109</u>	<u>16,406,983</u>	<u>(4,604,995)</u>	<u>324,133,097</u>
Income from operations	22,539,837	(9,911,213)	-	12,628,624
Nonoperating gains and losses				
Unrestricted income	171,387	-	-	171,387
Income/(loss) from investments	5,993,369	-	-	5,993,369
Loss on refinancing of debt	(2,026,984)	-	-	(2,026,984)
	<u>4,137,772</u>	<u>-</u>	<u>-</u>	<u>4,137,772</u>
Excess of revenues over expenses	<u>26,677,609</u>	<u>(9,911,213)</u>	<u>-</u>	<u>16,766,396</u>
Transfer to affiliate	(12,670,075)	-	-	(12,670,075)
Net unrealized (losses)/gains on investments	(6,282,024)	-	-	(6,282,024)
Net assets released from restriction used for the purchase of property, plant and equipment	176,082	-	-	176,082
Minimum pension liability adjustment	5,839,963	-	-	5,839,963
Decrease in unrestricted net assets	<u>\$ 13,741,555</u>	<u>\$ (9,911,213)</u>	<u>\$ -</u>	<u>\$ 3,830,342</u>

**Lawrence & Memorial Hospital**  
**Consolidating Statement of Operations**  
**September 30, 2010**

	<b>Lawrence &amp; Memorial Hospital</b>	<b>Associated Specialists of Connecticut</b>	<b>Eliminating Entities</b>	<b>Consolidated</b>
Net revenues	\$ 306,562,977	\$ 7,605,324	\$ -	\$ 314,168,301
Other operating revenues	14,292,897	20,732,875	(25,099,465)	9,926,307
Net assets released from restriction	412,940	-	-	412,940
	<u>321,268,814</u>	<u>28,338,199</u>	<u>(25,099,465)</u>	<u>324,507,548</u>
Operating expenses				
Salaries and wages	134,554,159	9,513,214	(68,299)	143,999,074
Employee benefits	39,948,123	1,747,633	(1,370,750)	40,325,006
Supplies	43,039,934	124,613	-	43,164,547
Purchased services	20,028,640	3,416,826	(2,352,226)	21,093,240
Other	28,636,252	1,273,647	(738,844)	29,171,055
Interest	2,332,245	-	-	2,332,245
Depreciation and amortization	16,728,407	-	-	16,728,407
Bad debts	14,381,176	671,159	-	15,052,335
	<u>299,648,936</u>	<u>16,747,092</u>	<u>(4,530,119)</u>	<u>311,865,909</u>
Income from operations	21,619,878	11,591,107	(20,569,346)	12,641,639
Nonoperating gains and losses				
Unrestricted income	175,335	-	-	175,335
(Loss)/income from investments	(18,227,950)	-	20,569,346	2,341,396
	<u>(18,052,615)</u>	<u>-</u>	<u>20,569,346</u>	<u>2,516,731</u>
Excess of revenues over expenses	<u>3,567,263</u>	<u>11,591,107</u>	<u>-</u>	<u>15,158,370</u>
Transfer to affiliate	(4,900,000)	-	-	(4,900,000)
Net unrealized gains on investments	5,459,058	-	-	5,459,058
Net assets released from restriction used for the purchase of property, plant and equipment	181,470	-	-	181,470
Minimum pension liability adjustment	(7,611,564)	-	-	(7,611,564)
Decrease in unrestricted net assets	<u>\$ (3,303,773)</u>	<u>\$ 11,591,107</u>	<u>\$ -</u>	<u>\$ 8,287,334</u>