



AUDITED CONSOLIDATED FINANCIAL
STATEMENTS AND OTHER FINANCIAL
INFORMATION

Hospital of Saint Raphael and Subsidiaries
Years Ended September 30, 2011 and 2010

Ernst & Young LLP

 **ERNST & YOUNG**

Hospital of Saint Raphael and Subsidiaries

Audited Consolidated Financial Statements
and Other Financial Information

Years Ended September 30, 2011 and 2010

Contents

Report of Independent Auditors.....	1
Consolidated Financial Statements	
Consolidated Balance Sheets	2
Consolidated Statements of Operations	4
Consolidated Statements of Changes in Net Assets	5
Consolidated Statements of Cash Flows.....	6
Notes to Consolidated Financial Statements.....	7
Other Financial Information	
Report of Independent Auditors on Other Financial Information	38
Consolidating Balance Sheet	39
Consolidating Statement of Operations	43

Report of Independent Auditors

The Board of Trustees
Hospital of Saint Raphael

We have audited the accompanying consolidated balance sheets of Hospital of Saint Raphael and Subsidiaries (the Hospital) as of September 30, 2011 and 2010, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Caritas Insurance Company, Ltd., a wholly owned subsidiary, which statements reflect total assets constituting 6.3% and 5.8% as of September 30, 2011 and 2010, respectively, of the related consolidated total. Those statements were audited by other auditors whose report has been furnished to us, and our opinion insofar as it relates to amounts included for Caritas Insurance Company, Ltd., is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hospital of Saint Raphael and Subsidiaries at September 30, 2011 and 2010, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Hospital will continue as a going concern. As more fully described in Note 1, the Hospital has incurred significant recurring operating losses, prior to 2011, and has not complied with certain financial covenants in accordance with its debt agreements. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The accompanying consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.



December 22, 2011

Hospital of Saint Raphael and Subsidiaries

Consolidated Balance Sheets

	September 30	
	2011	2010
	<i>(In thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 26,694	\$ 12,376
Short-term investments	1,157	2,314
Receivables:		
Patient care, net of allowance for doubtful accounts of \$26,068 in 2011 and \$19,872 in 2010	42,793	46,474
Due from third-party payers	6,665	4,952
Other receivables	2,254	2,682
Total receivables	51,712	54,108
Due from affiliates	–	13,312
Current portion of assets limited as to use	1,204	1,195
Inventories	7,424	7,914
Other current assets	232	431
Total current assets	88,423	91,650
Long-term investments	2,204	2,188
Assets limited as to use:		
Net funds held in escrow pursuant to tax-exempt bond agreements	7,477	7,470
Funds held in trust for estimated workers' compensation liabilities	7,504	7,413
Other investments	87,555	85,680
Less current portion	(1,204)	(1,195)
Total assets limited as to use, net of current portion	101,332	99,368
Property and equipment, net	91,355	94,202
Other long-term assets, including amounts due from third-party payers	7,460	8,614
Total assets	\$ 290,774	\$ 296,022

	September 30	
	2011	2010
	<i>(In thousands)</i>	
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 56,622	\$ 53,148
Interest payable	299	373
Due to third-party payers	4,864	1,937
Due to affiliates	—	—
Current portion of postretirement benefit obligations	1,700	6,200
Current portion of long-term debt	5,261	5,022
Long-term debt classified as payable in one year (<i>Notes 1 and 6</i>)	61,797	65,782
Total current liabilities	130,543	132,462
Estimated workers' compensation liabilities	6,981	6,429
Postretirement benefit obligations, net of current portion	140,965	108,026
Long-term debt, net of current portion and amounts classified as payable in one year (<i>Notes 1 and 6</i>)	661	1,946
Other long-term liabilities, including amounts due to third-party payers	52,354	49,279
Total liabilities	331,504	298,142
Net assets:		
Unrestricted	(71,511)	(32,809)
Temporarily restricted	19,691	17,620
Permanently restricted	11,090	13,069
	(40,730)	(2,120)
Total liabilities and net assets	\$ 290,774	\$ 296,022

See accompanying notes.

Hospital of Saint Raphael and Subsidiaries

Consolidated Statements of Operations

	Year Ended	
	September 30	
	2011	2010
	<i>(In thousands)</i>	
Unrestricted revenues, gains and other support:		
Net patient service revenue	\$ 477,957	\$ 471,037
Other, net	21,004	20,310
Net assets released from restrictions, used in operations	5,556	3,636
Total unrestricted revenues and other support	<u>504,517</u>	494,983
Expenses:		
Compensation, related fringe benefits, and fees	334,441	331,458
Supplies and other non-salary costs	128,774	121,769
Depreciation and amortization	13,478	14,607
Interest	2,513	2,902
Provision for uncollectible accounts	22,840	24,671
Total operating expenses	<u>502,046</u>	495,407
Operating income (loss)	2,471	(424)
Nonoperating income, net	<u>305</u>	234
Net income (loss) before change in unrealized gains and losses on investments	2,776	(190)
Change in unrealized gains and losses on investments	88	1,865
Net income	<u><u>\$ 2,864</u></u>	<u><u>\$ 1,675</u></u>

See accompanying notes.

Hospital of Saint Raphael and Subsidiaries

Consolidated Statements of Changes in Net Assets

Years Ended September 30, 2011 and 2010

	Total	Unrestricted	Temporarily Restricted Specific Purpose	Permanently Restricted Endowment
	<i>(In thousands)</i>			
Balances, September 30, 2009	\$ (24,147)	\$ (52,531)	\$ 15,697	\$ 12,687
Net income	1,675	1,675	-	-
Net assets released from restrictions for capital purposes	-	151	(151)	-
Transfers from affiliates, net	3,684	1,192	2,492	-
Change in unrealized gains and losses on investments	319	-	-	319
Restricted gifts, grants, and bequests	3,429	-	3,429	-
Restricted investment income (loss)	10	-	21	(11)
Net assets released from restrictions, used in operations	(3,636)	-	(3,636)	-
Postretirement benefit plan curtailment gain	40,995	40,995	-	-
Change in postretirement benefit plans' liability to be recognized in future periods	(24,291)	(24,291)	-	-
Change in the interest in net assets of Saint Raphael Foundation, Inc.	(158)	-	(232)	74
Change in net assets	<u>22,027</u>	<u>19,722</u>	<u>1,923</u>	<u>382</u>
Balances, September 30, 2010	<u>(2,120)</u>	<u>(32,809)</u>	<u>17,620</u>	<u>13,069</u>
Net income	2,864	2,864	-	-
Net assets released from restrictions for capital purposes	-	823	(823)	-
Transfers to affiliates, net	(14,149)	(15,643)	1,494	-
Change in unrealized gains and losses on investments	175	-	-	175
Restricted gifts, grants, and bequests	3,807	-	3,807	-
Restricted investment (loss) income	(142)	-	18	(160)
Net assets released from restrictions, used in operations	(5,556)	-	(5,556)	-
Change in postretirement benefit plans' liability to be recognized in future periods	(27,208)	(27,208)	-	-
Change in the interest in net assets of Saint Raphael Foundation, Inc.	1,599	-	1,519	80
Transfers between funds	-	462	1,612	(2,074)
Change in net assets	<u>(38,610)</u>	<u>(38,702)</u>	<u>2,071</u>	<u>(1,979)</u>
Balances, September 30, 2011	<u>\$ (40,730)</u>	<u>\$ (71,511)</u>	<u>\$ 19,691</u>	<u>\$ 11,090</u>

See accompanying notes.

Hospital of Saint Raphael and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended	
	September 30	
	2011	2010
	<i>(In thousands)</i>	
Cash flows from operating activities		
Change in net assets	\$ (38,610)	\$ 22,027
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Noncash items:		
Depreciation and amortization	13,478	14,607
Transfer to/from affiliates, net	14,149	(3,684)
Change in unrealized gains and losses on investments	(263)	(2,184)
Restricted gifts, grants, and bequests	(3,807)	(3,429)
Restricted investment loss (income)	142	(10)
Postretirement benefit plan curtailment gain	–	(40,995)
Change in postretirement benefit plans' liability to be recognized in future periods	27,208	24,291
Change in the interest in net assets of Saint Raphael Foundation, Inc.	(1,599)	158
Nonoperating (income), net	(305)	(234)
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Patient care receivables	3,681	7,192
Other receivables	(1,285)	(3,729)
Other assets	15,155	(9,279)
Increase (decrease) in:		
Accounts payable and other accruals	6,327	(2,778)
Estimated workers' compensation liabilities	552	(1,410)
Postretirement benefit obligations	1,231	(2,846)
Other long-term liabilities	3,075	6,100
Net cash provided by operating activities	39,129	3,797
Cash flows from investing activities		
Decrease (increase) in short-term investments	1,157	(2,305)
Increase in assets limited as to use, net	(1,710)	(3,192)
Nonoperating income, net	305	234
Restricted investment (loss) income	(142)	10
Increase in long-term investments	(16)	(680)
Capital expenditures, net	(10,631)	(8,692)
Net cash used in investing activities	(11,037)	(14,625)
Cash flows from financing activities		
Changes in the interest in net assets of Saint Raphael Foundation, Inc.	1,599	(158)
Transfer to/from affiliates, net	(14,149)	3,684
Restricted gifts, grants, and bequests	3,807	3,429
Principal payments of long-term debt	(5,031)	(4,788)
Net cash (used in) provided by financing activities	(13,774)	2,167
Net increase (decrease) in cash and cash equivalents	14,318	(8,661)
Cash and cash equivalents at beginning of year	12,376	21,037
Cash and cash equivalents at end of year	\$ 26,694	\$ 12,376
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 2,587	\$ 2,986

See accompanying notes.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2011
(Dollars in thousands)

1. Significant Accounting Policies

Organization

Hospital of Saint Raphael (the Hospital) is a tax-exempt, 511-bed tertiary level acute care hospital. The Hospital is a subsidiary of Saint Raphael Healthcare System, Inc. (the System), a tax-exempt, nonstock, holding company. The other active subsidiaries of the System are DePaul Health Services Corporation (DePaul), a taxable holding company; Saint Raphael Foundation, Inc. (the Foundation), a tax-exempt fund-raising foundation; Saint Regis Health Center, Inc., d/b/a Sister Anne Virginie Grimes Health Center (the Center), a tax-exempt skilled nursing facility; and Saint Raphael Healthcare System Affiliated Physicians, Inc. (Affiliated Physicians), a medical foundation.

The accompanying consolidated financial statements include the accounts of the Hospital, including its wholly-owned captive insurance company subsidiaries: Caritas Insurance Company, Ltd. (Caritas) and Lukan Indemnity Company, Ltd. (Lukan). All material intercompany transactions have been eliminated in consolidation.

Potential Affiliation With Yale-New Haven Hospital

On September 28, 2011 the System and Yale-New Haven Hospital (a 966-bed not-for-profit hospital located in New Haven, Connecticut (YNHH), serving as the primary teaching hospital for the Yale University School of Medicine) announced the signing of a definitive agreement (dated September 26, 2011) for YNHH and its parent company (Yale-New Haven Health Services Corporation) to purchase a majority of the assets of the consolidated Hospital and the Center, the restricted assets of the Foundation and certain assets of DePaul. This agreement is contingent upon regulatory review by appropriate state and federal agencies. During this review period both organizations continue to operate independently.

Operational Uncertainties

As of September 30, 2011, the Hospital remains out of compliance with certain financial covenant requirements of its long-term debt agreements (see Note 6, Long-Term Debt). Negotiations continue with the various parties to the Hospital's long-term debt agreements, although a resolution acceptable to all parties is yet to be achieved. The unresolved long-term debt financial covenant violations create the possibility that an existing event of default, if declared, could result in the acceleration of substantially all of the Hospital's long-term debt which raises substantial doubt about the Hospital's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments that might result

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Significant Accounting Policies (continued)

from the outcome of this uncertainty. This situation has been ongoing since fiscal year end 2008, with no event of default having been declared.

The Hospital continues to make all principal and interest payments on its long-term debt in accordance with the applicable amortization schedules.

Financial performance reflects an operating gain of \$2,471 for fiscal 2011 and an operating loss of \$424 for fiscal 2010. At September 30, 2011, the Hospital's unrestricted net asset deficiency increased to approximately \$71.5 million from approximately \$32.8 million as of September 30, 2010. This increase is primarily related to the approximately \$27.2 million change in postretirement benefit plans' liability. The cumulative net asset reduction due to the change in the postretirement benefit plans' liability is approximately \$95.9 million at September 30, 2011 (see Note 9, Postretirement Benefits).

Other Revenues

Other revenues primarily consist of transactions unrelated to the specific health care activities of the Hospital and include nonpatient revenues from occupational health, parking, cafeteria, and other sources including investment gains and losses on certain unrestricted investments.

Nonoperating Income

Nonoperating income, net, primarily consists of unrestricted investment income, including realized gains and losses.

Net Income and Changes in Net Assets

The performance indicator is net income, which for fiscal 2011 includes all changes in unrestricted net assets other than the change in postretirement plans' liability to be recognized in future periods, net assets released from restrictions for capital purposes, and reclassifications between funds. For fiscal 2010, the postretirement benefit plan curtailment gain was also excluded from the performance indicator.

Income Taxes

The Hospital and Caritas are tax-exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code. Lukan is presently nontaxable under Bermuda law.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Significant Accounting Policies (continued)

Cash and Cash Equivalents

The Hospital reports all unrestricted highly liquid investments with an initial maturity of three months or less as a component of cash and cash equivalents. Total deposits with financial institutions at times exceed the amount insured by federal agencies and, therefore, bear a risk of loss.

Inventories of Supplies

Inventories, consisting mainly of medical and surgical supplies, are stated at the lower of average cost or market determined by the first-in, first out method.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation of property and equipment is provided on the straight-line method over the estimated useful lives of the various assets (or for capitalized leases, the lesser of the estimated useful lives of the asset or the lease term, whichever is shorter), with half-year depreciation generally recorded in the year of acquisition and disposition. The American Hospital Association recommended lives are primarily used and provide for lives of 25 to 50-years for buildings and 3 to 20 years for building fixtures and equipment.

Investments

The Hospital's investments and assets limited as to use reported in the accompanying consolidated balance sheets are a trading portfolio, with unrealized gains and losses of unrestricted investments included in net income.

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. Fair value is determined based on quoted market prices. Investment income or loss (including realized gains and losses on investments, interest income, and dividends) and unrealized gains and losses on investments are included in net income, unless the income or loss is restricted by donor or law.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Significant Accounting Policies (continued)

When investments are received as a donation or bequest, the fair value is recorded as the cost of the investment. Interest, dividends, and realized gains or losses are recorded in unrestricted net assets unless otherwise restricted by the contributors. Restricted investment income is added directly to the appropriate restricted net asset fund.

Fair Value of Financial Instruments

Information regarding the fair value of investments and long-term debt is included in Note 13, Fair Value Measurements. For other monetary assets and liabilities, the carrying value approximates fair value based on current market conditions.

Assets Limited as to Use

Assets limited as to use include certain funds held in escrow pursuant to tax-exempt bond agreements (see Note 6, Long-Term Debt), funds held in trust for estimated workers' compensation liabilities (see Note 9, Self-Insurance Programs), other assets whose use is limited, which primarily reflect the assets of Lukan and Caritas (see Note 9, Self-Insurance Programs), and the Hospital's interest in the net assets of the Foundation. Amounts required to meet current liabilities have been reclassified to current assets in the accompanying consolidated balance sheets.

Net Assets

Separate accounts are maintained by the Hospital to ensure compliance with restrictions imposed by contributors on the use of donated funds. Substantially all of the assets of such funds are invested in marketable securities.

Temporarily restricted net assets are those assets whose use has been limited by donors for a specific purpose. Permanently restricted net assets must be maintained by the Hospital in perpetuity. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose of restriction is accomplished, temporarily restricted net assets used in operations are reclassified and reported in the consolidated financial statements as net assets released from restrictions.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the accompanying consolidated financial statements and related notes, such as: estimated uncollectibles for patient receivables; estimated receivables and payables to and from third-party payers; and the disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. Management believes the amounts recorded based on estimates and assumptions are reasonable and any differences between estimates and actual should not have a material effect on the Hospital's financial position.

Reclassifications

Certain reclassifications have been made to the amounts reported for fiscal 2010 to conform the presentation with the 2011 presentation. These reclassifications had no effect on total net assets.

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 and for the year ended September 30, 2011. The Hospital evaluated subsequent events through December 22, 2011, which is the date the financial statements were issued. No events occurred that require disclosure or adjustment to the consolidated financial statements.

Recently Issued Accounting Standards

In August 2010, the Financial Accounting Standards Board (FASB) issued amended guidance relating to measuring charity care for disclosures. The amended guidance requires that the level of charity care provided be presented based on the direct and indirect costs of the charity services provided. Separate disclosure of the amount of any cash reimbursements received for providing charity care must also be disclosed. The Hospital will be required to adopt the disclosures required by the amended guidance for periods beginning after December 15, 2010.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Significant Accounting Policies (continued)

In June 2011, the FASB issued amended guidance related to the presentation and disclosure of patient service revenue, provision for uncollectible accounts and the allowance for doubtful accounts for certain health care entities. Under the new guidance, certain health care entities will be required to reclassify the provision for bad debts associated with patient service revenue from an operation expense to a deduction from patient service revenue. Separate disclosure regarding policies for recognizing revenue and assessing bad debts as well as qualitative and quantitative information about changes in the allowance for doubtful accounts must also be disclosed. The Hospital will be required to adopt the presentation and disclosures required by the amended guidance for periods beginning after December 15, 2011.

2. Net Patient Service Revenue

Revenues from the Medicare and Medicaid programs accounted for 46.0% and 11.5%, respectively, of the Hospital's net patient service revenue for the year ended September 30, 2011 and 46.7% and 8.4%, respectively, for the year ended September 30, 2010. 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 such regulatory inquiries are outstanding, 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, reduction of funding levels and changes in estimates could have an adverse impact on the Hospital.

The following summarizes net patient service revenue:

	Year Ended September 30	
	2011	2010
Gross patient service revenue	\$ 1,368,811	\$ 1,274,386
Deductions:		
Allowances	(885,301)	(799,625)
Charity care (at charges)	(5,553)	(3,724)
	(890,854)	(803,349)
Net patient service revenue	\$ 477,957	\$ 471,037

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Net Patient Service Revenue (continued)

Patient accounts receivable and revenues are recorded when patient services are performed. Net patient service revenue is reported at the estimated net realizable amounts from patients and third-party payers for services rendered. Revenue received under third-party payer agreements is subject to audit and retroactive adjustments. Provisions for third-party payer settlements and adjustments are estimated in the period the related services are rendered and adjusted in future periods as final settlements are determined. Retroactive adjustments related to settlements with third-party payers increased the Hospital's net patient service revenues in fiscal 2011 by approximately \$1,452 and decreased the Hospital's net patient services revenues in fiscal 2010 by approximately \$359.

The Hospital has agreements with various commercial insurers and managed care organizations (MCOs) to provide medical services to subscribing participants. Under these agreements, the MCOs make payments to the Hospital for certain covered services based upon negotiated pricing for the services provided.

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer arrangements. The approximate mix of patient care receivables at September 30, 2011 and 2010 is as follows:

	<u>2011</u>	<u>2010</u>
Medicare	39%	36%
Medicaid	11	11
Blue Cross	14	14
Commercial and other	30	31
Self-pay	6	8
Total	<u>100%</u>	<u>100%</u>

3. Uncompensated Care and Community Benefit Expense

The Hospital is committed to the community by providing services to the poor and the medically underserved, as well as providing benefits to the broader community. Focused on providing nondiscriminatory treatment of all patients, the Hospital fosters universal access to emergency care regardless of ability to pay. Services provided to the poor and the medically underserved include services provided to persons who cannot afford health care due to a lack of resources, lack of insurance, or both.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

3. Uncompensated Care and Community Benefit Expense (continued)

The Hospital considers care provided for which no payment was received from the patient or their insurer as uncompensated care. Uncompensated care is composed of free care provided, charity care provided, and bad debt expense. In determining uncompensated care, the Hospital excludes voluntary and involuntary discounts or “reductions in revenue,” such as underpayments from Medicare and Medicaid or discounts to managed care companies. Consistent with the reporting requirements of the State of Connecticut Office of Health Care Access, uncompensated care is reported at customary (undiscounted) charges; for the years ended September 30, 2011 and 2010, uncompensated care amounted to approximately \$28,624 and \$30,062, respectively.

The Hospital makes available free care programs for qualifying patients. In accordance with the established policies of the Hospital during the registration, billing, and collection processes, a patient’s eligibility for free care funds is determined. For the years ended September 30, 2011 and 2010, free care funds provided to patients qualifying for these assistance programs at customary charges were approximately \$3 and \$36, respectively.

The Hospital makes available financial assistance programs for qualifying patients. In accordance with the established policies of the Hospital during the registration, billing, and collection processes, a patient’s eligibility for financial assistance is determined. For the years ended September 30, 2011 and 2010, financial assistance provided at customary charges was approximately \$5,781 and \$5,355, respectively.

For patients who were determined to have the ability to pay but did not, the Hospital’s provision for uncollectible accounts is bad debt expense. For the years ended September 30, 2011 and 2010, bad debt expense was approximately \$22,840 and \$24,671, respectively.

Annually, the Hospital accrues for the potential losses related to its uncompensated care. At September 30, 2011 and 2010, the amount estimated by management to represent the Hospital’s uncompensated care allowances, which is included in the accompanying consolidated balance sheets as a reduction of accounts receivable for services to patients, was approximately \$26,068 and \$19,872, respectively.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

3. Uncompensated Care and Community Benefit Expense (continued)

Additionally, the Hospital reaches out to the broader community, which includes services provided to other needy populations that may not qualify as poor but need special services and support, by increasing access to services, educating the public about disease prevention, providing goods and services, and advocating health care coverage for all. These benefits include the cost of health promotion and education of the general community, interns and residents, health screenings, and medical research. These benefits are provided through the Project Mother Care services, a mobile Dental Van, community health centers, neighborhood schools, various community support groups, and *Better Health* magazine.

The Hospital also makes contributions to programs, organizations, and foundations for efforts on behalf of the poor, the disadvantaged, and the community in general. These include the Hospital of Saint Raphael One-For-All Fund, Inc., sponsored by employees, which annually donates approximately \$100 to local community-based organizations, and a variety of in-kind services, including vaccination programs to police and paramedic personnel, supplies and medical equipment to various organizations, shelters and relief programs, technical assistance in the areas of printing and graphic design, and use of space for community meetings.

4. Investments

Short-term investments and long-term investments at September 30, 2011 and 2010 primarily consist of government and corporate bonds. Fair value and cost information for these investments at September 30, 2011 and 2010 is summarized as follows:

	Fair Value	Cost	Net Unrealized (Depreciation) Appreciation
2011			
Corporate and government bonds	<u>\$ 3,361</u>	<u>\$ 3,399</u>	<u>\$ (38)</u>
2010			
Corporate and government bonds	<u>\$ 4,502</u>	<u>\$ 4,484</u>	<u>\$ 18</u>

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Investments (continued)

Other assets limited as to use comprise investments related to permanently restricted endowments, temporarily restricted specific-purpose funds, and unrestricted investments held by the Hospital's captive insurance company subsidiaries. Fair value and cost information for the Hospital's investments at September 30, 2011 and 2010, are summarized as follows:

	Fair Value	Cost	Net Unrealized Appreciation (Depreciation)
2011			
Cash	\$ 7,459	\$ 7,459	\$ —
Certificates of deposit	1,369	1,369	—
Money market mutual funds	14,199	14,199	—
Fixed income mutual funds	28,056	27,320	736
Equity mutual funds	12,881	13,957	(1,076)
Other	1,262	1,262	—
	\$ 65,226	\$ 65,566	\$ (340)
2010			
Cash	\$ 8,782	\$ 8,782	\$ —
Certificates of deposit	1,365	1,365	—
Money market mutual funds	15,326	15,326	—
Corporate and government bonds	12,229	11,607	622
Fixed income mutual funds	13,885	13,290	595
Common stock	8,093	9,310	(1,217)
Equity mutual funds	4,586	5,425	(839)
Other	684	685	(1)
	\$ 64,950	\$ 65,790	\$ (840)

Also included in other assets limited as to use is the Hospital's interest in the net assets of the Foundation of \$21,343 and \$19,744 as of September 30, 2011 and 2010, respectively. Property held for investment (at amortized cost) of \$986 is also included in other assets limited as to use at September 30, 2011 and 2010.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Investments (continued)

Unrestricted income from the Hospital's investments is included as nonoperating income (loss) in the accompanying consolidated statements of operations. The components of nonoperating income for September 30, 2011 and 2010, are summarized as follows:

	2011	2010
Income from assets limited as to use and other unrestricted funds	\$ 98	\$ 80
Unrestricted income from trust and endowment funds	207	154
Nonoperating income, net	\$ 305	\$ 234

Funds held for estimated workers' compensation liabilities at September 30, 2011 and 2010, are summarized as follows:

	Fair Value	Cost	Net Unrealized Appreciation (Depreciation)
2011			
Money market funds	\$ 4,942	\$ 4,942	\$ -
Corporate and government bonds	2,562	2,573	(11)
	\$ 7,504	\$ 7,515	\$ (11)
2010			
Money market funds	\$ 4,422	\$ 4,422	\$ -
Corporate and government bonds	2,991	2,830	161
	\$ 7,413	\$ 7,252	\$ 161

Investment gains and losses from the workers' compensation trust fund investments are included in other revenues, net, in the accompanying consolidated statements of operations. Investment income, net was \$272 and \$159 for fiscal 2011 and 2010, respectively.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

5. Property and Equipment

The components of property and equipment at September 30, 2011 and 2010, are as follows:

	<u>2011</u>	<u>2010</u>
Land	\$ 2,991	\$ 2,880
Land improvements	3,073	3,073
Buildings and improvements	181,644	178,290
Fixed equipment	46,060	46,000
Movable equipment	208,485	204,006
Construction in progress	2,002	396
	<u>444,255</u>	<u>434,645</u>
Less accumulated depreciation	<u>(352,900)</u>	<u>(340,443)</u>
	<u>\$ 91,355</u>	<u>\$ 94,202</u>

6. Long-Term Debt

The Hospital's long-term debt consists of the following at September 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
State of Connecticut Health and Educational Facilities Authority (CHEFA):		
Tax-Exempt Bonds, Series H	\$ 12,790	\$ 16,570
Tax-Exempt Bonds, Series L	27,599	27,599
Tax-Exempt Bonds, Series M	25,367	25,367
Easyloan Master Financing Agreement	1,947	3,187
Original issue premium, net	16	27
	<u>67,719</u>	<u>72,750</u>
Less current portion	(5,261)	(5,022)
Less amounts classified as payable in one year	<u>(61,797)</u>	<u>(65,782)</u>
	<u>\$ 661</u>	<u>\$ 1,946</u>

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

6. Long-Term Debt (continued)

As discussed below, the Obligated Group (defined below) is not in compliance with certain financial covenants of its long term debt agreements. Negotiations regarding modifications to the terms of the existing agreements to resolve the financial covenant violations have been ongoing, and mutual agreement among the involved parties has not been reached. As a result of the financial covenant violations, the possibility of the declaration of an event of default and the related possibility of acceleration of payment terms, certain long-term debt amounts noted above have been reclassified as a current obligation in the accompanying consolidated balance sheets as of September 30, 2011 and 2010.

The CHEFA bonds outstanding as of September 30, 2011 bear interest and have terms as follows:

Issue	Year	Interest Rate	Principal Payments	
			Begin	End
Series H	1994	5.25% to 6.5%	July 1, 1994	July 1, 2014
Series L	2005	Variable	July 1, 2015	July 1, 2024
Series M	2005	Variable	July 1, 2015	July 1, 2024

Principal payments on the outstanding bonds are scheduled as follows: \$3,975 in 2012; \$4,235 in 2013; \$4,520 in 2014; \$4,361 in 2015; \$4,562 in 2016; and \$44,103 thereafter.

Under the terms of the Series H, Series L, and Series M loan agreements, the members of the Obligated Group are jointly and severally liable for all issued and outstanding CHEFA revenue bonds in the event of a default. The current members of the Obligated Group are the System, the Hospital, the Center, the Foundation, and DePaul.

The Series H and Series L bonds issued are insured by AMBAC Assurance Corporation and are secured by a pledge of gross receipts of the Obligated Group members and by a mortgage on substantially all property owned by the Hospital and the Center. The Series M bonds have credit enhancement provided by a letter of credit with a bank (currently extended through June 2012), and are also secured by a pledge of gross receipts of the Obligated Group members and by a mortgage on substantially all property owned by the Hospital and the Center. Negotiations are ongoing with the letter of credit provider regarding further extension of the letter of credit.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

6. Long-Term Debt (continued)

The terms of the Series H, Series L and Series M loan agreements provide for, among other provisions, financial covenants requiring on a consolidated basis: (1) maintenance of specified long-term debt service coverage at the end of each fiscal quarter; (2) maintenance of specified long-term debt to capitalization at the end of each fiscal quarter; (3) maintenance of specified fund balance at the end of each fiscal quarter; (4) maintenance of specified short-term indebtedness at the end of each fiscal quarter; and (5) maintenance of specified days cash on hand semiannually at March 31 and September 30. As of September 30, 2011, the Obligated Group is not in compliance with the financial covenants to maintain the following: the specified long-term indebtedness to capitalization; the specified minimum fund balance; and the specified days cash on hand. The Obligated Group has requested modifications to the terms of the existing agreements to resolve the financial covenant violations for these matters; negotiations regarding resolution of these matters are ongoing.

The Series L bonds are auction rate securities. In the event that the weekly auctions fail to clear, the interest rate associated with these securities defaults to a formula, as described in the bond documents. The formula used to calculate the interest rate for the auctions that fail would be 175% of the defined index increasing to 265% of the defined index if the bond insurer's rating falls below investment grade. Since 2008, the Hospital's auctions failed to clear. Due to the further downgrade of the bond insurer during fiscal 2009, the Obligated Group has been required to pay interest at 265% of the defined index (since August 2009). Interest rates (based on the defined index) on this debt ranged from 0.58% to 1.17% during fiscal 2011, and ranged from 0.32% to 0.48% during fiscal 2010.

The Series M Bonds are variable rate demand obligations. In addition to the letter of credit fee paid to the bank, interest rates on this debt ranged from 0.13% to 0.45% during fiscal 2011 and from 0.21% to 0.39% during fiscal 2010.

In connection with the Series H, Series L, and Series M bonds, various debt service reserve funds have been established to provide security for the bondholders. In connection with the original Series H loan agreement, a depreciation reserve fund had been established to provide for debt service and the purchase of replacement assets over the life of the debt. These balances, in addition to the required quarterly principal and interest payment deposits, are included in assets limited as to use in the accompanying consolidated balance sheets. The assets primarily consist of U.S. Treasury bonds and are carried at fair value, which approximates carrying value. The balance in the debt service reserve funds was approximately \$6,273 and \$6,276 at September 30, 2011 and 2010, respectively.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

6. Long-Term Debt (continued)

Expenses associated with the issuance of the CHEFA bonds have been deferred and are being amortized over the life of the related debt. These deferred bond issuance costs are included as other long-term assets in the accompanying consolidated balance sheets.

During fiscal 2006, the Hospital acquired certain equipment under a master financing agreement among a bank, CHEFA and the Hospital. Principal payments on this debt, which began in 2007, are as follows: \$1,286 in 2012 and \$661 in 2013.

7. Restricted Net Assets

Endowment Funds

The Hospital's endowments consist of approximately 25 donor restricted funds established for a variety of purposes. The net assets associated with endowment funds are classified and reported based on the donor-imposed restrictions.

The Hospital has interpreted the UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and, if applicable (c) accumulations to the permanent endowment made in accordance with the related gift's donor instructions. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the donor intention. The Hospital considers the following factors in making determinations to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of Hospital
- (7) The investment policies of the Hospital

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Restricted Net Assets (continued)

Endowment Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Hospital to retain as a fund of perpetual duration. There were no deficiencies of this nature reported in unrestricted net assets as of September 30, 2011 and 2010.

Return Objectives and Risk Parameters

The Hospital's Board of Trustees has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets.

Endowment assets include those assets of donor-restricted funds that the Hospital must hold in perpetuity or for a donor-specified period. The Hospital expects its endowment funds, over time, to provide an average rate of return of approximately 8% annually; actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy 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) and current yield (interest and dividends). The Hospital targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Hospital has a policy of appropriating for distribution each year between 3 and 6 percent of its endowment fund's average fair value over the prior three years (through the calendar yearend immediately preceding the beginning of the fiscal year in which the distribution is planned), with an average annual target of 4 percent. In establishing this policy, the Hospital considered the long-term expected return on its endowment noted above. Accordingly, over the long term, the Hospital expects the current spending policy to allow its endowment to grow at an average of 4 percent annually. This is consistent with the Hospital's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Restricted Net Assets (continued)

Endowment Net Asset Composition by Type of Fund as of September 30, 2011

All endowment net assets are donor-restricted endowment funds.

Changes in Endowment Net Assets for the Fiscal Year Ended September 30, 2011

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning balance	\$ 719	\$ 13,069	\$ 13,788
Total investment return	28	95	123
Contributions	-	-	-
Appropriation of endowment assets for expenditure	(1,022)	-	(1,022)
Reclassifications	2,074	(2,074)	-
Endowment net assets, ending balance	<u>\$ 1,799</u>	<u>\$ 11,090</u>	<u>\$ 12,889</u>

Changes in Endowment Net Assets for the Fiscal Year Ended September 30, 2010

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning balance	\$ 690	\$ 12,687	\$ 13,377
Total investment return	29	382	411
Contributions	-	-	-
Appropriation of endowment assets for expenditure	-	-	-
Reclassifications	-	-	-
Endowment net assets, ending balance	<u>\$ 719</u>	<u>\$ 13,069</u>	<u>\$ 13,788</u>

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Restricted Net Assets (continued)

Temporarily Restricted

Temporarily restricted net assets are available for the following purposes as of September 30, 2011 and 2010:

	2011	2010
Health education	27%	33%
Equipment purchases	25	20
Indigent care	7	9
All other	41	38
	100%	100%

8. Transactions with Affiliated Corporations

At September 30, 2011 and 2010, the following net amounts were due from affiliates:

	2011	2010
Saint Regis Health Center, Inc.	\$ –	\$ 6,094
DePaul Health Services Corporation	–	2,991
Saint Raphael Healthcare System, Inc.	–	3,343
Saint Raphael Foundation, Inc.	–	884
	\$ –	\$ 13,312

Amounts due from/due to affiliates have arisen primarily from cash advances between the Hospital and affiliated corporations and are non interest-bearing.

Transfers to affiliates, net, for fiscal 2011 reflects unrestricted amounts transferred to the System \$(3,284), DePaul \$(2,593), the Foundation \$(1,867), the Center \$(6,969), and Affiliated Physicians \$(930); net of restricted amounts transferred from the Foundation \$(1,494). Transfers to affiliates, net, for fiscal 2010 reflects \$1,192 of unrestricted and \$2,492 of restricted amounts transferred from the Foundation.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

9. Self-Insurance Programs

Malpractice and General Liability

During fiscal 2011 and 2010, the Hospital's malpractice coverage was provided by a "claims-made" insurance program through its wholly owned subsidiaries, Lukan and Caritas. The liability for incurred but not reported claims of \$2,559 and \$2,760 as of September 30, 2011 and 2010, respectively, has been retained at the Hospital.

Effective October 1, 1992, the Hospital formed Lukan. Lukan is a wholly owned subsidiary of the Hospital and a Bermuda captive insurance company which provides the first level of the Hospital's "claims-made" insurance coverage. Coverage for the years ended September 30, 2011 and 2010 was \$2,000 per claim and \$10,000 in the aggregate.

Effective October 1, 1989, the Hospital formed Caritas. This wholly owned subsidiary of the Hospital, a Vermont captive insurance company, currently provides the remainder of the Hospital's "claims-made" coverage. Coverage for the years ended September 30, 2010 and 2009 was \$28,000 per claim and \$48,000 in the aggregate; of this coverage, \$20,000 per claim and \$40,000 in the aggregate was provided under a reinsurance agreement with a commercial insurer.

Assets held by Lukan and Caritas were \$53,012 and \$51,456 as of September 30, 2011 and 2010, respectively, and are reflected as other assets whose use is limited in the accompanying consolidated balance sheets. Liabilities recorded by Lukan and Caritas were \$37,468 and \$35,535 as of September 30, 2011 and 2010, respectively, and are reflected as other long-term liabilities in the accompanying consolidated balance sheets.

The actuary estimated the liability for unpaid losses based on industry data, as well as entity-specific data. Management considers the liability to be adequate as of September 30, 2011 and 2010; however, no assurance can be given that the ultimate settlement of losses may not vary materially from the liability recorded. Future adjustments to the amounts recorded resulting from the continual review process, as well as differences between estimates and ultimate payments, will be reflected in the consolidated statements of operations of future years when such adjustments, if any, become known.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

9. Self-Insurance Programs (continued)

Activity in the estimated liability for outstanding losses and loss-related expenses at Lukan and Caritas for the years ended September 30, 2011 and 2010, is summarized as follows:

	2011	2010
Balance, beginning of year	\$ 34,907	\$ 31,403
Losses incurred related to:		
Current year	10,114	10,852
Prior years	(5,187)	(3,695)
Total incurred	4,927	7,157
Paid losses related to:		
Current year	(226)	(99)
Prior years	(3,297)	(3,554)
Total paid	(3,523)	(3,653)
Balance, end of year	\$ 36,311	\$ 34,907

As a result of changes in management's estimates of the ultimate settlement amount of claims reported in prior years, incurred losses and loss adjustment expenses decreased by \$5,187 and \$3,695 during fiscal 2011 and 2010, respectively.

Workers' Compensation

Effective October 1, 1991, the Hospital became self-insured for the deductible portion of workers' compensation claims. Based upon fiscal 2008 financial performance, the Hospital was notified during fiscal 2009 that the state of Connecticut would no longer permit the self-insurance of workers' compensation claims after April 17, 2009. The Hospital has obtained commercial insurance coverage for such claims arising after this date. The workers' compensation trust fund will continue to cover the costs of claims arising through the date of the change.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

9. Self-Insurance Programs (continued)

For the applicable periods of fiscal 2009, the deductibles for the self-insured program were \$1,000 per occurrence, with an aggregate maximum of \$1,000 per year. The Hospital has purchased statutory umbrella insurance coverage with a commercial carrier through September 30, 2011. The Hospital is required to maintain a performance bond related to this self-insurance program; as of September 30, 2010, the Hospital provided \$4,900 of cash collateral to the performance bond provider via a custody arrangement with a bank; such direct collateral was funded by a withdrawal from the related trust.

The Hospital established an irrevocable trust to hold assets, accumulate income, and pay settled claims and expenses related to the workers' compensation self-insurance program for deductibles. Amounts are charged to expense and funds are deposited into the trust based upon an actuarial determination of the Hospital's liability. A discount rate of 3% and 4% was used in the determination of this liability for fiscal 2011 and 2010, respectively. Trust fund deposits at September 30, 2011 and 2010 are invested by the trustee in marketable securities (See Note 4, Investments).

Activity in the workers' compensation asset and self-insurance liability accounts for the years ended September 30, 2011 and 2010, was as follows:

	2011		2010	
	Asset	Liability	Asset	Liability
Trust fund balance, beginning of year	\$ 3,163	\$ 6,429	\$ 7,328	\$ 7,839
Current year expense	-	1,935	-	658
Hospital contribution	1,794	-	1,897	-
Investment gains and losses, net	272	-	159	-
Change in unrealized gains and losses on investments	(172)	-	97	-
Reinsurance receivable	-	420	-	-
Performance bond collateral	(650)	-	(4,250)	-
Settlement of claims	(1,045)	(1,045)	(1,476)	(1,476)
Fund expenses	(758)	(758)	(592)	(592)
Trust fund balance, end of year	2,604	6,981	3,163	6,429
Performance bond collateral	4,900	-	4,250	-
Total assets and liabilities	\$ 7,504	\$ 6,981	\$ 7,413	\$ 6,429

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Postretirement Benefits

Pensions

The Hospital has a noncontributory defined benefit retirement plan, which is funded in accordance with a method approved by the Board of Trustees. Benefits payable under this plan are based on credited years of service and earnings as defined in the plan documents. During fiscal 2004, participation in the plan was limited to eligible employees hired through December 31, 2003. During fiscal 2010, participation in the plan was frozen for benefits accumulated as of December 31, 2009; accordingly, a curtailment gain of approximately \$41 million was recognized and included in the accompanying consolidated statements of changes in net assets. Pension cost for the defined benefit retirement plan was approximately \$1,727 and \$5,141 for fiscal 2011 and 2010, respectively.

Effective January 1, 2004, for eligible new hires subsequent to December 31, 2003, the Hospital has a noncontributory defined contribution retirement plan. Deposits into this plan are based on credited years of service and earnings as defined in the plan documents. During fiscal 2010, participation in the plan was suspended for benefits earned as of December 31, 2009. Pension cost for the defined contribution retirement plan was approximately \$272 for fiscal 2010. It is possible that this plan will be amended at some point in the future to include those employees who were previously eligible to participate in the noncontributory defined benefit retirement plan through December 31, 2009.

For fiscal 2011 and 2010, the majority of the Hospital's employees were eligible to participate in a 401(k) savings plan sponsored by the Hospital. The System matches one dollar for every dollar contributed by an employee into the Plan, up to 3% compensation as defined. During fiscal 2010, participation in the plan was suspended for contributions made after April 12, 2010. Savings plan expense was approximately \$126 and \$2,015 for fiscal 2011 and 2010, respectively.

The Hospital has a nonqualified supplemental retirement plan for certain executives. During 2010, participation in this nonqualified plan was suspended for periods after April 3, 2010. Nonqualified retirement plan expense was approximately \$282 for fiscal 2010.

Certain skilled maintenance employees are covered under a multi-employer union pension plan. Union retirement plan expense was approximately \$427 and \$344 for fiscal 2011 and 2010, respectively.

The total pension expense for the years ended September 30, 2011 and 2010 was approximately \$2,281 and \$8,054, respectively.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Postretirement Benefits (continued)

Restoration of currently suspended pension benefits for Hospital employees will be dependent upon sustained improvements in operating results for fiscal 2012 and beyond.

Medical and Life Insurance

The Hospital utilizes the attribution method of accounting for the actuarially determined cost of providing medical and life insurance benefits to eligible retirees, where the cost of providing the postretirement benefits is accrued during the active service period of the employee. Effective during fiscal 2004, the ability to participate in this benefit plan was frozen for all existing employees at that date based on a combination of age and years of service.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act) was enacted on December 8, 2003. The Act introduced a prescription drug benefit under Medicare 9. (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The Hospital's estimate of its postretirement obligation, net periodic postretirement benefit cost, and the corresponding disclosures reflect the effects of the Act on the medical and life insurance plan.

The assumed health care cost trend rate used was 8% in 2011 reaching an ultimate trend rate of 5% in 2016 and later. If the health care cost trend rate was increased by 1%, the periodic expense would be increased by \$49. If the health care cost trend rate was decreased by 1%, the periodic expense would be decreased by \$43.

Postretirement Benefit Costs

Included in unrestricted net assets at September 30, 2011 and 2010, are the following amounts that have not yet been recognized in net periodic benefit cost:

	2011		2010	
	Pension	Insurance	Pension	Insurance
Unrecognized actuarial loss	<u><u>\$(91,738)</u></u>	<u><u>\$(4,190)</u></u>	<u><u>\$(65,649)</u></u>	<u><u>\$(3,071)</u></u>

The unrecognized actuarial loss included in unrestricted net assets at September 30, 2011 and expected to be recognized in net periodic benefit costs during the year ending September 30, 2012, are \$1,748 and \$183 for pension and insurance, respectively.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Postretirement Benefits (continued)

The following table sets forth the funded status of the postretirement benefit plans and the related amounts recognized in the Hospital's consolidated financial statements at September 30, 2011 and 2010:

	2011		2010	
	Pension	Insurance	Pension	Insurance
Change in benefit obligations:				
Benefit obligations, at beginning of year	\$ 206,122	\$ 20,431	\$ 213,390	\$ 18,702
Service cost	–	43	1,620	54
Interest cost	10,474	1,018	11,169	1,014
Actuarial loss	18,252	1,251	25,824	2,265
Plan curtailment	–	–	(40,995)	–
Benefits paid	(5,220)	(1,858)	(4,886)	(1,808)
Federal subsidy on benefits paid	–	204	–	204
Benefit obligations, at end of year	229,628	21,089	206,122	20,431
Change in plan assets at fair value:				
Plan assets, beginning of year	112,327	–	98,316	–
Actual return on plan assets	945	1,654	11,446	–
Employer contribution	–	(1,858)	7,451	1,604
Benefits paid	(5,220)	204	(4,886)	(1,808)
Federal subsidy on benefits paid	–	–	–	204
Plan assets, end of year	108,052	–	112,327	–
Funded status of plan	\$ (121,576)	\$ (21,089)	\$ (93,795)	\$ (20,431)

The accumulated benefit obligation at September 30, 2011 and 2010, was \$229,628 and \$206,122, respectively.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Postretirement Benefits (continued)

The following assumptions were used in calculating and determining the actuarial present value of the accumulated benefit obligations and net periodic benefit cost at September 30, 2011 and 2010:

	2011		2010	
	Pension	Insurance	Pension	Insurance
Discount rate for projected benefit obligation	4.60%	4.60%	5.15%	5.15%
Discount rate for net periodic benefit cost	5.15%	5.15%	5.60%	5.60%
Long-term rate of return on plan assets	7.75%	N/A	7.75%	N/A
Average rate of increase in compensation	N/A	N/A	N/A	3.00%

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.

Net postretirement benefit costs for fiscal 2011 and 2010 included the following components:

	2011		2010	
	Pension	Insurance	Pension	Insurance
Service cost – benefits earned during the period	\$ –	\$ 43	\$ 1,620	\$ 54
Interest cost on projected benefit obligation	10,474	1,018	11,169	1,014
Expected return on plan assets	(9,744)	–	(9,697)	–
Amortization of unrecognized net loss (gain)	997	97	1,747	–
Plan curtailment	–	–	277	–
Amortization of prior service cost	–	–	25	–
Net periodic benefit cost	\$ 1,727	\$ 1,158	\$ 5,141	\$ 1,068

Contributions

The Hospital expects to make no contribution to its defined benefit pension plan and approximately \$1,700 to its medical and life insurance plan in fiscal 2012.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Postretirement Benefits (continued)

Estimated Future Cash Flows

The following benefit payments (which reflect expected future service, as appropriate) are expected to be paid, and the following Medicare Part D subsidies are expected to be received, approximately as follows:

Fiscal Year	Pension Payments	Insurance Payments	Medicare Part D Receipts
2012	\$ 7,084	\$ 1,693	\$ 203
2013	7,921	1,739	200
2014	8,648	1,778	194
2015	9,364	1,813	187
2016	10,028	1,826	178
Years 2017–2021	58,927	8,492	723

Pension Plan Assets

The defined benefit pension 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 holding among sectors, industries, and companies. No more than 5% of the plan's portfolio (excluding U.S. government securities and cash) may be held in an individual company's stocks or bonds with no more than twice the industry weighting listed in the most appropriate benchmark factor for that industry. The assets of the plan are measured at fair value in accordance with the policies discussed in Note 1. Refer to Note 13 for fair value measurement information related to plan asset categories noted in the table below. The Hospital's defined benefit pension plan allocations at September 30, 2011 and 2010, by asset category, are as follows:

Asset Category	2011	2010
Equity securities	55.8%	53.1%
Debt securities	43.7	39.0
Cash and accrued income	0.5	7.9
Total	<u>100.0%</u>	<u>100.0%</u>

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

11. Functional Expenses

The Hospital provides tertiary level health care services to residents within its geographic location. The approximate proportion of program services and administrative expenses for the years ended September 30, 2011 and 2010 is as follows:

	<u>2011</u>	<u>2010</u>
Health care services	86%	86%
Administrative and general	14	14
	<u>100%</u>	<u>100%</u>

12. Commitments and Contingencies

Leases

The Hospital is a party to various operating leases for property and equipment. Rental expense amounted to approximately \$11,513 and \$10,995 for the years ended September 30, 2011 and 2010, respectively. Minimum future rental commitments on all noncancelable operating leases with initial or remaining terms of more than one year are as follows: \$3,925 in 2011; \$2,872 in 2012; \$1,987 in 2013; \$1,241 in 2014; \$815 in 2015; and \$2,666 thereafter.

Litigation

The Hospital is involved in litigation arising in the ordinary course of business. In the opinion of management, the final resolution of these legal matters will not have a material effect on the Hospital's consolidated financial position.

13. Fair Value Measurements

For assets and liabilities required to be measured at fair value, the Hospital measures fair value 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. Fair value measurements are applied based on the unit of account from the Hospital's perspective.

The unit of account determines what is being measured by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting pronouncements.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

13. Fair Value Measurements (continued)

The Hospital follows a valuation hierarchy that prioritizes observable and unobservable inputs

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 is 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 uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers nonperformance risk in its assessment of fair value.

The fair value of CHEFA Series H bonds, determined using quoted market prices at the valuation date, was approximately \$12,689 and \$16,560 at September 30, 2011 and September 30, 2010, respectively. As the Series L and M bonds have variable interest rates, fair value is considered to be equal to carrying value.

The following is a description of the Hospital's valuation methodologies for assets measured at fair value. Fair value for Level 1 is based upon quoted market prices. 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.

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

13. Fair Value Measurements (continued)

Financial assets, including defined benefit retirement plan assets, carried at fair value as of September 30, 2011, 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>
Cash and cash equivalents				
Cash and cash equivalents	\$ 26,694	\$ -	\$ -	\$ 26,694
Unrestricted (short-term and long-term) investments				
Corporate and government bonds (c)	\$ -	\$ 3,361	\$ -	\$ 3,361
Other assets limited as to use				
Cash	\$ 8,331	\$ -	\$ -	\$ 8,331
Certificates of deposits (a)	1,369	-	-	1,369
Money market mutual funds (b)	14,199	-	-	14,199
Fixed income mutual funds (d)	75,275	-	-	75,275
Equity mutual funds (f)	71,775	1,367	-	73,142
Others (g)	962	-	-	962
	<u>\$ 171,911</u>	<u>\$ 1,367</u>	<u>\$ -</u>	<u>\$ 173,278</u>
Other assets limited to use	\$ 65,226	\$ -	\$ -	\$ 65,226
Defined benefit retirement plan	106,685	1,367	-	108,052
Total	<u>\$ 171,911</u>	<u>\$ 1,367</u>	<u>\$ -</u>	<u>\$ 173,278</u>

Hospital of Saint Raphael and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

13. Fair Value Measurements (continued)

Financial assets, including defined benefit retirement plan assets, carried at fair value as of September 30, 2010 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents				
Cash and cash equivalents	\$ 12,376	\$ –	\$ –	\$ 12,376
Unrestricted (short-term and long-term) investments				
Corporate and government bonds (c)	\$ –	\$ 4,502	\$ –	\$ 4,502
Other assets limited as to use				
Cash	\$ 17,421	\$ –	\$ –	\$ 17,421
Certificates of deposits (a)	1,365	–	–	1,365
Money market mutual funds (b)	15,326	–	–	15,326
Corporate and Government Bonds (c.)	–	27,584	–	27,584
Fixed Income Mutual Funds (d)	42,365	–	–	42,365
Common Stock (e)	51,527	–	–	51,527
Equity Mutual Funds (f)	19,275	1,501	–	20,776
Others (g)	913	–	–	913
	<u>\$ 148,192</u>	<u>\$ 29,085</u>	<u>\$ –</u>	<u>\$ 177,277</u>
Other assets limited to use	\$ 51,710	\$ 28,164	\$ –	\$ 79,874
Defined benefit retirement plan	95,471	16,856	–	112,327
Total	<u>\$ 147,181</u>	<u>\$ 45,020</u>	<u>\$ –</u>	<u>\$ 192,201</u>

(a) Investments in short-term certificates of deposit with area banking institutions

(b) Investments in mutual funds that invest primarily in short-term debt securities, including US Treasury bills, commercial paper and certificates of deposit

(c) Investments in a diverse portfolio of short-term high quality bonds, actively managed primarily across the mortgage-backed security, US Treasury and corporate fixed income sectors

(d) Investments in fixed income mutual funds that maintain short and mid-term high-quality corporate bonds of companies primarily domiciled in the United States

(e) Investments in a diverse portfolio of common stock of corporations primarily domiciled in the United States, including small-cap, mid-cap and large-cap holdings

(f) Investments in domestic and international equity mutual funds and exchange-traded funds, including small-cap, mid-cap and large-cap holdings

(g) Primarily reflects captive insurance companies' premium & reinsurance recoverable receivables and other current assets; also includes net accrued income and expenses

Other Financial Information

Report of Independent Auditors on Other Financial Information

The Board of Trustees
Hospital of Saint Raphael and Subsidiaries

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The following consolidating other financial information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole. No provision for any adjustments that may result from the outcome of the going concern uncertainty as explained in our report on the consolidated financial statements has been made in the information.

Ernst & Young LLP

December 22, 2011

Hospital of Saint Raphael and Subsidiaries

Consolidating Balance Sheet

September 30, 2011

	Hospital of Saint Raphael	Lukan Indemnity Company, Ltd.	Caritas Insurance Company, Ltd.	Eliminations	Total
	<i>(In thousands)</i>				
Assets					
Current assets:					
Cash and cash equivalents	\$ 26,694	\$ —	\$ —	\$ —	\$ 26,694
Short-term investments	1,157	—	—	—	1,157
Receivables:					
Patient care, net of allowance for doubtful accounts of \$26,068	42,793	—	—	—	42,793
Due from third-party payers	6,665	—	—	—	6,665
Other receivables	2,254	—	—	—	2,254
Total receivables	51,712	—	—	—	51,712
Due from affiliates	—	—	—	—	—
Current portion of assets limited as to use	1,204	—	—	—	1,204
Inventories	7,424	—	—	—	7,424
Other current assets	232	—	—	—	232
Total current assets	88,423	—	—	—	88,423
Long-term investments	2,204	—	—	—	2,204
Assets limited as to use:					
Net funds held in escrow pursuant to tax-exempt bond agreements	7,477	—	—	—	7,477
Funds held in trust for estimated workers' compensation liabilities	7,504	—	—	—	7,504
Other investments	42,413	34,714	18,298	(7,870)	87,555
Less current portion	(1,204)	—	—	—	(1,204)
Total assets limited as to use, net of current portion	56,190	34,714	18,298	(7,870)	101,332
Property and equipment, net	91,355	—	—	—	91,355
Other long-term assets, including amounts due from third-party payers	7,460	—	—	—	7,460
Total assets	\$ 245,632	\$ 34,714	\$ 18,298	\$ (7,870)	\$ 290,774

Hospital of Saint Raphael and Subsidiaries

Consolidating Balance Sheet (continued)

September 30, 2011

	Hospital of Saint Raphael	Lukan Indemnity Company, Ltd.	Caritas Insurance Company, Ltd.	Eliminations	Total
	<i>(In thousands)</i>				
Liabilities and net assets					
Current liabilities:					
Accounts payable and accrued expenses	\$ 56,622	\$ —	\$ —	\$ —	\$ 56,622
Interest payable	299	—	—	—	299
Due to third-party payers	4,864	—	—	—	4,864
Due to affiliates	—	—	—	—	—
Current portion of postretirement benefit obligations	1,700	—	—	—	1,700
Current portion of long-term debt	5,261	—	—	—	5,261
Long-term debt classified as payable in one year <i>(Notes 1 and 6)</i>	61,797	—	—	—	61,797
Total current liabilities	130,543	—	—	—	130,543
Estimated workers' compensation liabilities	6,981	—	—	—	6,981
Postretirement benefit obligations, net of current portion	140,965	—	—	—	140,965
Long-term debt, net of current portion and amounts classified as payable in one year <i>(Notes 1 and 6)</i>	661	—	—	—	661
Other long-term liabilities, including amounts due to third-party payers	14,886	29,495	7,973	—	52,354
Total liabilities	294,036	29,495	7,973	—	331,504
Net assets:					
Unrestricted	(79,185)	5,219	10,325	(7,870)	(71,511)
Temporarily restricted	19,691	—	—	—	19,691
Permanently restricted	11,090	—	—	—	11,090
	(48,404)	5,219	10,325	(7,870)	(40,730)
Total liabilities and net assets	\$ 245,632	\$ 34,714	\$ 18,298	\$ (7,870)	\$ 290,774

Hospital of Saint Raphael and Subsidiaries

Consolidating Balance Sheet

September 30, 2010

	Hospital of Saint Raphael	Lukan Indemnity Company, Ltd.	Caritas Insurance Company, Ltd.	Eliminations	Total
	<i>(In thousands)</i>				
Assets					
Current assets:					
Cash and cash equivalents	\$ 12,376	\$ —	\$ —	\$ —	\$ 12,376
Short-term investments	2,314	—	—	—	2,314
Receivables:					
Patient care, net of allowance for doubtful accounts of \$19,872	46,474	—	—	—	46,474
Due from third-party payers	4,952	—	—	—	4,952
Other receivables	2,682	—	—	—	2,682
Total receivables	54,108	—	—	—	54,108
Due from affiliates	13,312	—	—	—	13,312
Current portion of assets limited as to use	1,195	—	—	—	1,195
Inventories	7,914	—	—	—	7,914
Other current assets	431	—	—	—	431
Total current assets	91,650	—	—	—	91,650
Long-term investments	2,188	—	—	—	2,188
Assets limited as to use:					
Net funds held in escrow pursuant to tax-exempt bond agreements	7,470	—	—	—	7,470
Funds held in trust for estimated workers' compensation liabilities	7,413	—	—	—	7,413
Other investments	42,094	34,396	17,060	(7,870)	85,680
Less current portion	(1,195)	—	—	—	(1,195)
Total assets limited as to use, net of current portion	55,782	34,396	17,060	(7,870)	99,368
Property and equipment, net	94,202	—	—	—	94,202
Other long-term assets, including amounts due from third-party payers	8,614	—	—	—	8,614
Total assets	\$ 252,436	\$ 34,396	\$ 17,060	\$ (7,870)	\$ 296,022

Hospital of Saint Raphael and Subsidiaries

Consolidating Balance Sheet (continued)

September 30, 2010

	Hospital of Saint Raphael	Lukan Indemnity Company, Ltd.	Caritas Insurance Company, Ltd.	Eliminations	Total
	<i>(In thousands)</i>				
Liabilities and net assets					
Current liabilities:					
Accounts payable and accrued expenses	\$ 53,148	\$ —	\$ —	\$ —	\$ 53,148
Interest payable	373	—	—	—	373
Due to third-party payers	1,937	—	—	—	1,937
Due to affiliates	—	—	—	—	—
Current portion of postretirement benefit obligations	6,200	—	—	—	6,200
Current portion of long-term debt	5,022	—	—	—	5,022
Long-term debt classified as payable in one year <i>(Notes 1 and 6)</i>	65,782	—	—	—	65,782
Total current liabilities	132,462	—	—	—	132,462
Estimated workers' compensation liabilities	6,429	—	—	—	6,429
Postretirement benefit obligations, net of current portion	108,026	—	—	—	108,026
Long-term debt, net of current portion and amounts classified as payable in one year <i>(Notes 1 and 6)</i>	1,946	—	—	—	1,946
Other long-term liabilities, including amounts due to third-party payers	13,744	29,033	6,502	—	49,279
Total liabilities	262,607	29,033	6,502	—	298,142
Net assets:					
Unrestricted	(40,860)	5,363	10,558	(7,870)	(32,809)
Temporarily restricted	17,620	—	—	—	17,620
Permanently restricted	13,069	—	—	—	13,069
	(10,171)	5,363	10,558	(7,870)	(2,120)
Total liabilities and net assets	\$ 252,436	\$ 34,396	\$ 17,060	\$ (7,870)	\$ 296,022

Hospital of Saint Raphael and Subsidiaries

Consolidating Statement of Operations

September 30, 2011

	Hospital of Saint Raphael	Lukan Indemnity Company, Ltd.	Caritas Insurance Company, Ltd.	Eliminations	Total
	<i>(In thousands)</i>				
Unrestricted revenues, gains and other support:					
Net patient service revenue	\$ 477,957	\$ –	\$ –	\$ –	\$ 477,957
Other revenues, net	17,978	6,190	396	(3,560)	21,004
Net assets released from restrictions, used in operations	5,556	–	–	–	5,556
Total unrestricted revenues and other support	501,491	6,190	396	(3,560)	504,517
Expenses:					
Compensation, related fringe benefits, and fees	334,441	–	–	–	334,441
Supplies and other non-salary costs	125,050	5,486	1,798	(3,560)	128,774
Depreciation and amortization	13,478	–	–	–	13,478
Interest	2,513	–	–	–	2,513
Provision for uncollectible accounts	22,840	–	–	–	22,840
Total operating expenses	498,322	5,486	1,798	(3,560)	502,046
Operating income (loss)	3,169	704	(1,402)	–	2,471
Nonoperating income, net	305	–	–	–	305
Net income (loss) before change in unrealized gains and losses on investments	3,474	704	(1,402)	–	2,776
Change in unrealized gains and losses on investments	(234)	(848)	1,170	–	88
Net income (loss)	\$ 3,240	\$ (144)	\$ (232)	\$ –	\$ 2,864

Hospital of Saint Raphael and Subsidiaries

Consolidating Statement of Operations

September 30, 2010

	Hospital of Saint Raphael	Lukan Indemnity Company, Ltd.	Caritas Insurance Company, Ltd.	Eliminations	Total
	<i>(In thousands)</i>				
Unrestricted revenues, gains and other support:					
Net patient service revenue	\$ 471,037	\$ –	\$ –	\$ –	\$ 471,037
Other revenues, net	16,659	7,523	1,296	(5,168)	20,310
Net assets released from restrictions, used in operations	3,636	–	–	–	3,636
Total unrestricted revenues and other support	491,332	7,523	1,296	(5,168)	494,983
Expenses:					
Compensation, related fringe benefits, and fees	331,458	–	–	–	331,458
Supplies and other non-salary costs	117,832	7,831	1,271	(5,165)	121,769
Depreciation and amortization	14,607	–	–	–	14,607
Interest	2,905	–	–	(3)	2,902
Provision for uncollectible accounts	24,671	–	–	–	24,671
Total operating expenses	491,473	7,831	1,271	(5,168)	495,407
Operating (loss) income	(141)	(308)	25	–	(424)
Nonoperating income, net	234	–	–	–	234
Net income (loss) before change in unrealized gains and losses on investments	93	(308)	25	–	(190)
Change in unrealized gains and losses on investments	116	1,028	721	–	1,865
Net income	\$ 209	\$ 720	\$ 746	\$ –	\$ 1,675

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