

The New Milford Hospital, Incorporated and Subsidiaries
Independent Auditors' Report, Consolidated Financial
Statements and Other Financial Information
As of and for the Years Ended September 30, 2009 and 2008

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Independent Auditors' Report

To the Board of Directors of
The New Milford Hospital, Incorporated and Subsidiaries:

We have audited the accompanying consolidated balance sheets of The New Milford Hospital, Incorporated and Subsidiaries (the Hospital, formerly the New Milford Holding Corporation and Subsidiaries, see Note 1), a Connecticut not-for-profit, non-stock corporation, as of September 30, 2009 and 2008, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of the New Milford Visiting Nurse Association, Inc., a wholly owned subsidiary, which statements reflect total assets of \$3,118,403 and \$3,197,047 as of June 30, 2009 and 2008, respectively, and total revenues of \$3,618,786 and \$3,319,864 for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the New Milford Visiting Nurse Association, Inc., 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 of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the 2009 and 2008 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The New Milford Hospital, Incorporated and Subsidiaries as of September 30, 2009 and 2008, and the results of its consolidated operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, effective October 1, 2008 the Hospital adopted the provisions of Emerging Issues Task Force Issue No. 06-10 "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements*," which has been superseded by FASB Accounting Standards Codification 715-60 "*Defined Benefit Plans - Other Postretirement*", which resulted in a change in the Hospital's method of accounting for the asset value in its collateral assignment split-dollar life insurance arrangement.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The other financial information listed within the table of contents 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 entities. Accordingly, we do not express an opinion on the financial position and results of operations of the individual entities. However, the consolidating information has been subjected to the auditing procedures applied in the audit 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.

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March 9, 2010

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The New Milford Hospital, Incorporated and Subsidiaries
Consolidated Balance Sheets
September 30, 2009 and 2008

	2009	2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 3,470,654	\$ 5,649,889
Restricted cash for SERP	1,095,852	1,135,356
Short-term investments	195,420	830,159
Accounts receivable, net of allowance of \$3,087,262 in 2009 and \$2,657,262 in 2008	11,329,197	11,674,918
Pledges receivable, current	223,358	792,478
Land held for sale	1,600,000	2,000,000
Prepaid expenses	3,007,450	2,342,535
Other receivables	545,245	876,584
Inventories	2,035,077	2,090,275
Total current assets	23,502,253	27,392,194
Other assets:		
Investments (VNA)	1,539,224	1,693,105
Investments (Foundation)	8,228,236	5,644,587
Assets held by trustees - restricted to use	3,654,449	3,760,930
Pledges receivable, long-term	351,388	350,625
Other assets	804,444	1,448,625
	14,577,741	12,897,872
Property, plant and equipment:		
Land and land improvements	1,546,857	1,546,857
Buildings	46,125,430	45,307,482
Equipment	44,413,090	43,371,879
Construction in progress	668,678	-
	92,754,055	90,226,218
Less: accumulated depreciation	(60,856,636)	(55,868,113)
Net property, plant and equipment	31,897,419	34,358,105
Total assets	\$ 69,977,413	\$ 74,648,171
Liabilities and Net Assets		
Current liabilities:		
Bank line of credit	\$ -	\$ 2,070,000
Accounts payable and accrued expenses	7,819,842	6,480,392
Accrued salaries, wages and fees	2,986,189	2,823,714
Amounts due for SERP liability	1,095,852	1,135,356
Due to third party payers	2,389,775	1,302,333
Current portion of long-term debt	1,662,730	1,332,761
Total current liabilities	15,954,388	15,144,556
Other accrued expenses	2,284,464	1,886,628
Accrued pension liability	20,426,162	4,845,380
Long-term debt, less current portion	7,543,997	9,206,726
Total liabilities	46,209,011	31,083,290
Net assets:		
Unrestricted	9,579,333	29,244,007
Temporarily restricted	10,534,620	10,559,944
Permanently restricted	3,654,449	3,760,930
Total net assets	23,768,402	43,564,881
Total liabilities and net assets	\$ 69,977,413	\$ 74,648,171

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

The New Milford Hospital, Incorporated and Subsidiaries
Consolidated Statements of Operations
For the Years Ended September 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Operating revenues:		
Net patient service revenues	\$ 92,906,929	\$ 92,113,898
Contributions for cancer center operations	-	134,407
Net assets released from restrictions used for operations	1,022,024	1,967,745
Other revenues	<u>3,787,899</u>	<u>4,376,159</u>
Total operating revenues	<u>97,716,852</u>	<u>98,592,209</u>
 Operating expenses:		
Salaries and wages	42,871,480	40,612,156
Employee benefits	13,348,463	11,864,325
Supplies and other	38,112,851	38,299,986
Depreciation and amortization	4,988,522	4,979,589
Provision for bad debts	3,220,173	3,761,404
Interest	<u>675,584</u>	<u>730,698</u>
Total operating expenses	<u>103,217,073</u>	<u>100,248,158</u>
 Loss from operations	(5,500,221)	(1,655,949)
 Other income:		
Non-operating gains	162,119	256,373
Contributions	<u>173,032</u>	<u>248,631</u>
 Excess of revenues under expenses	<u>\$ (5,165,070)</u>	<u>\$ (1,150,945)</u>

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

The New Milford Hospital, Incorporated and Subsidiaries
Consolidated Statements of Changes in Net Assets
For the Years Ended September 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Unrestricted net assets:		
Excess of revenues under expenses	\$ (5,165,070)	\$ (1,150,945)
Net assets released for capital acquisitions	67,303	654,578
Net unrealized losses on interest rate swap contract	(360,318)	(269,835)
Net unrealized losses on investments	(188,554)	(86,592)
Pension changes other than net periodic benefit costs	(13,148,781)	(3,774,909)
Cumulative effect of a change in accounting principle	(869,254)	-
Change in unrestricted net assets	<u>(19,664,674)</u>	<u>(4,627,703)</u>
Temporarily restricted net assets:		
Contributions	1,385,404	4,188,023
Investment income	309,501	409,689
Loss on land held for sale	(400,000)	-
Net realized losses on investments	(391,384)	(87,560)
Net assets released for operations	(1,022,024)	(1,967,745)
Net assets released from restrictions for capital	(67,303)	(654,578)
Net unrealized gains (losses) on investments	136,132	(393,456)
Special events	24,350	73,425
Change in temporarily restricted net assets	<u>(25,324)</u>	<u>1,567,798</u>
Permanently restricted net assets:		
Net unrealized losses on investments		
held in trust by others	(106,481)	(852,869)
Change in permanently restricted net assets	<u>(106,481)</u>	<u>(852,869)</u>
Change in net assets	(19,796,479)	(3,912,774)
Net assets, beginning of year	<u>43,564,881</u>	<u>47,477,655</u>
Net assets, end of year	<u><u>\$ 23,768,402</u></u>	<u><u>\$ 43,564,881</u></u>

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

The New Milford Hospital, Incorporated and Subsidiaries
Consolidated Statements of Cash Flows
For the Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities and nonoperating gains:		
Change in net assets	\$ (19,796,479)	\$ (3,912,774)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	4,988,522	4,979,589
Provision for bad debts	3,220,173	3,761,404
Net unrealized losses on investments	158,903	1,332,917
Loss on land held for sale	400,000	-
Net realized losses on investments	391,384	87,560
Pension changes other than net periodic benefit costs	13,148,781	3,774,909
Net periodic benefit cost	2,439,309	1,285,737
Restricted contributions and investment income	(1,719,255)	(4,671,138)
Changes in operating working capital	1,407,407	(5,081,652)
Net cash provided by operating activities	4,638,745	1,556,552
Cash flows from investing activities:		
Additions to property, plant, and equipment	(2,527,837)	(3,795,413)
Sales (purchases) of short-term investments	634,739	(33,812)
Purchases of long-term investments	(3,280,881)	(39,083)
Net cash used in investing activities	(5,173,979)	(3,868,308)
Cash flows from financing activities:		
Change in restricted cash for SERP	39,504	(1,135,356)
Payments on long-term debt	(1,332,760)	(1,255,817)
Payments on bank line of credit	(2,070,000)	818,000
Restricted contributions and investment income	1,719,255	4,671,138
Net cash (used in) provided by financing activities	(1,644,001)	3,097,965
Net change in cash and cash equivalents	(2,179,235)	786,209
Cash and cash equivalents, beginning of year	5,649,889	4,863,680
Cash and cash equivalents, end of year	\$ 3,470,654	\$ 5,649,889
Details of changes in operating working capital:		
Accounts receivable	\$ (2,874,452)	\$ (4,878,925)
Pledges receivable	568,357	931,653
Prepaid expenses	(664,915)	(434,525)
Other receivables	331,339	(331,097)
Inventories	55,198	(356,705)
Land held for sale	400,000	(2,000,000)
Other assets	644,181	35,937
Accounts payable and accrued expenses	1,339,450	775,056
Amount due for SERP liability	(39,504)	1,135,356
Accrued salaries, wages and fees	162,475	(76,937)
Due to third party payers	1,087,442	(493,950)
Other accrued expenses	397,836	612,485
	\$ 1,407,407	\$ (5,081,652)

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

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 1 - General

Organization - New Milford Hospital, Incorporated, is a voluntary, not-for-profit, non-stock corporation incorporated under the General Statutes of the State of Connecticut and is the sole corporate member of its subsidiaries, New Milford Hospital Foundation, Inc. and New Milford Visiting Nurse Association, Inc.

New Milford Hospital Foundation, Inc. (the Foundation), was incorporated as a not-for-profit, non-stock corporation incorporated under the General Statutes of the State of Connecticut and is operated, in part, to maintain a capital campaign fund and solicit and receive contributions on behalf of The New Milford Hospital, Incorporated and other Section 501(c)(3) organizations affiliated with the Hospital.

New Milford Visiting Nurse Association, Inc. (the VNA) was incorporated in 1918 in Connecticut as a not-for-profit corporation. The VNA provides health and supportive services to individuals at their homes, primarily in New Milford, Connecticut and neighboring communities.

The VNA operates on a fiscal year ending June 30th. There are no intervening events that occurred after June 30, 2009 that would materially affect the September 30, 2009 financial statements of the Hospital.

The New Milford VNA Foundation, Inc. (VNA Foundation), was incorporated as a not-for-profit, non-stock corporation incorporated under the General Statutes of the State of Connecticut and is operated, in part, to maintain a capital campaign fund and solicit and receive contributions on behalf of the VNA. The VNA Foundation's assets and net assets are not included within these consolidated financial statements, as the Hospital does not have significant control over the operations of the VNA Foundation.

Principles of Consolidation - The consolidated financial statements include the accounts of the Hospital, the Foundation and the VNA (Hospital). Intercompany accounts and transactions have been eliminated in consolidation.

Affiliation - The Hospital has an affiliation agreement with Columbia Presbyterian Medical Center (CPMC), which enables the Hospital to become a part of an integrated, cost-effective, healthcare delivery system consisting of strong, independent community-based hospitals in the tri-state area. The Hospital retains its autonomy and independence while participating within the CPMC Network.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 2 - Summary of Significant Accounting Policies

Accounting Standards Codification - In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 168, “*FASB Accounting Standards Codification (ASC) and the Hierarchy of Generally Accepted Accounting Principles - A Replacement of FASB Statement No. 162*”. This guidance establishes the FASB Accounting Standards Codification (FASB ASC) as the source of authoritative accounting principles generally accepted in the United States of America (GAAP). The FASB ASC supersedes all existing accounting and reporting standards for non-public entities. This guidance is effective for financial statements issued for periods ending after September 15, 2009. As the FASB ASC did not change existing GAAP, the adoption of this guidance did not have an impact on the consolidated financial condition or results of operations.

Use of Estimates - The preparation of consolidated financial statements in conformity with auditing standards generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. While management believes the estimates and assumptions used in the preparation of the consolidated financial statements are appropriate, actual results could differ from those estimates.

Cash and Cash Equivalents - Cash and cash equivalents consist of cash and short-term investments with a maturity of three months or less when purchased. The Federal Depository Insurance Corporation (FDIC) insures cash balances up to \$250,000 per customer, per bank. In addition, FDIC coverage for balances in non-interest bearing transaction deposit accounts is unlimited if the bank elects to participate. Amounts in excess of the FDIC limits are uninsured. Most of the Hospital’s banking activity, including cash and cash equivalents, is maintained with several regional banks and, from time-to-time, exceeds FDIC limits. It is the Hospital’s policy to monitor these banks’ financial strength on an ongoing basis.

Restricted Cash - Restricted cash as of September 30, 2009 and 2008 consists of cash designated by the Hospital for Supplemental Executive Retirement Plan (SERP), see Note 5.

Short-term Investments - Short-term investments consist of certificates of deposit with original maturities of four months or longer.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 2 - Summary of Significant Accounting Policies (continued)

Split-Dollar Life Insurance Policies - Split-dollar life insurance policies are included within other assets and prior to October 1, 2008, were carried at the lower of the policies' cash surrender value or total policy premiums paid by the Hospital. Effective October 1, 2008, the Hospital adopted the provisions of Emerging Issues Task Force Issue No. 06-10 "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements*" (EITF 06-10), which has been superseded by FASB ASC 715-60 "*Defined Benefit Plans - Other Postretirement*". Under EITF 06-10, the Hospital is required to value the asset in a collateral assignment split-dollar life insurance arrangement based on the future cash flows to which the Hospital is entitled. Consequently, the Hospital has reduced the carrying amount of the asset by \$869,254, as of October 1, 2008, to reflect the present value of the future cash flows that it expects to receive under this agreement. This reduction in unrestricted net assets is reflected on the consolidated statements of changes in net assets as a cumulative effect of adopting EITF 06-10.

Inventories - Inventories, used in general operations of the Hospital, are stated at average cost.

Investments - Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value on the balance sheet. Fair value is 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 under expenses unless the income or loss is restricted by donor or law.

Other Than Temporary Impairments on Investments - When a decline in fair market value is deemed to be other than temporary, a provision for impairment is charged to non-operating income, included in other than temporary impairments on investments, and the cost basis of that investment is reduced.

For equity securities, the Hospital's management reviews several factors to determine whether a loss is other than temporary, such as the length of time a security is in a unrealized loss position, extent to which the fair value is less than cost, the financial condition and near term prospects of the issuer and the Hospital's intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value. There were no impairment losses recorded during the years ended September 30, 2009 and 2008.

The Hospital adopted FASB ASC 320-10, "*Investments - Debt and Equity Securities*" (which encompassed FSP FAS115-2 and FAS 124-2, "*Recognition and Presentation of Other-Than-Temporary Impairments*" (FSP FAS 115-2/124-2)), which relates to fixed income securities.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 2 - Summary of Significant Accounting Policies (continued)

This guidance requires the Hospital to evaluate whether it intends to sell an impaired fixed income security or whether it is more likely than not that it will be required to sell an impaired fixed income security before recovery of the amortized cost basis. If either of these criteria are met, an impairment equal to the difference between the fixed income security's amortized cost and its fair value is recognized in earnings.

For impaired fixed income securities that do not meet these criteria, the Hospital determines if a credit loss exists with respect to the impaired security. If a credit loss exists, the credit loss component of the impairment is recognized in earnings and the remaining portion of the impairment is recognized as a component of changes in net assets within unrealized depreciation on investments.

Property, Plant and Equipment - Property, plant and equipment are stated at cost. The Hospital provides for depreciation of property, plant and equipment using the half-year convention method in amounts sufficient to amortize the cost of its assets over their estimated useful lives.

Real Estate - Assets received as donations or bequests are recorded at their fair value as of the date received and depreciated using the straight-line method in amounts sufficient to amortize the cost of the assets over their estimated useful lives.

Other Income - Activities other than those in connection with providing healthcare services are considered to be non-operating. Non-operating gains primarily consist of income on invested funds and unrestricted donations and contributions.

Excess of Revenues Under Expenses - The consolidated statements of operations includes excess of revenues over (under) expenses. Changes in unrestricted net assets which are excluded from excess of revenues under expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets, including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets.

Professional Liability Insurance - Professional liability insurance coverage was provided under claims-made policies. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. Management estimates and records a liability for incurred but not reported incidents (IBNR). The total reserve, including IBNR, for September 30, 2009 and 2008 was \$1,282,735 and \$922,735, respectively, and has been accrued within accrued expenses on the consolidated balance sheets.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 2 - Summary of Significant Accounting Policies (continued)

Income Taxes - The Hospital, the Foundation, and the VNA are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (IRC) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the IRC.

FASB ASC 740-10, "*Income Taxes*" is effective for the Hospital for fiscal year 2010 and establishes a threshold for financial statement recognition of the benefit of positions taken in filing tax returns (including whether an entity is taxable in a particular jurisdiction), and requires certain expanded tax disclosures. FASB ASC 740-10 is to be applied to all open tax years as of the date of effectiveness. The adoption of FASB ASC 740-10 is not expected to have a material impact on the consolidated financial statements. Currently, the Hospital accounts for uncertain tax positions in accordance with the measurement criteria of FASB ASC 450, "*Contingencies*."

Temporarily and Permanently Restricted Net Assets - Temporarily restricted net assets are those whose use has been limited by donors to a specific time frame or purpose and are included within investments. Temporarily restricted net assets are available primarily for health care services, including cancer programs and capital replacement.

Permanently restricted net assets consist of permanently restricted endowments, which are included in assets held by trustees - restricted to use. Permanently restricted net assets are restricted primarily for investments to be held in perpetuity, the income from which is expendable to support health care services.

Donor Restricted Gifts - Unconditional promises to give cash and other assets to the Foundation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. 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 as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

The income earned on restricted funds is generally available for operations of the Hospital and is recorded as revenue in unrestricted net assets, unless restricted by the donor at which time the income is added to the appropriate restricted net asset balance. Administration of restricted funds is subject to the general provisions of the Uniform Management of Institutional Funds Act (UMIFA) as updated by the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 2 - Summary of Significant Accounting Policies (continued)

Under the provisions of this law, a governing board may appropriate for expenditure, for the uses and purposes for which an endowment fund is established, so much of the net appreciation as is deemed prudent based on standards established by UMIFA and UPMIFA. While a governing board must exercise ordinary business care in the appropriation of such appreciation, the general provisions of UMIFA and UPMIFA do not mandate that institutions retain endowment gains permanently. Accordingly, institutions that are subject to general UMIFA and UPMIFA provisions report gains on endowment assets as temporarily restricted net assets until those amounts are appropriated for expenditure by the Board of Trustees. However, if a specific gift instrument explicitly requires the reinvestment of appreciation, or a portion thereof, such reinvested amounts shall be classified within permanently restricted net assets. In addition, the Board of Director's and management of the VNA have determined that the VNA's investment portfolio, included within long-term investments, with a fair market value of \$1,539,224 as of September 30, 2009 does not meet the definition of an endowment under FASB ASC 958-205 "*Presentation of Financial Statements.*"

Reclassifications - Certain 2008 amounts have been reclassified to conform to the 2009 presentation. These reclassifications are not material to the overall financial statements.

Note 3 - Current Economic Conditions

The current economic environment presents health care entities with unprecedented circumstances and challenges, which, in some cases, have resulted in large declines in the fair value of investments and other assets, large declines in contributions, constraints on liquidity and difficulty obtaining financing. The consolidated financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the State may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the consolidated financial statements could change rapidly, resulting in material future adjustments in investment values and allowances for accounts receivable that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 4 - Revenues from Services to Patients and Charity Care

The following table summarizes net revenues from services to patients by the Hospital:

	<u>2009</u>	<u>2008</u>
Gross revenues from patients	\$ 234,092,596	\$ 218,177,759
Deductions and exclusions:		
Allowances	138,119,122	122,298,071
Uncompensated care pool	(319,679)	(303,282)
Charity care	3,386,224	4,069,072
	<u>141,185,667</u>	<u>126,063,861</u>
Net patient service revenues	<u>\$ 92,906,929</u>	<u>\$ 92,113,898</u>

Patient accounts receivable and revenues are recorded when patient services are performed. Amounts received from certain payers are different from established billing rates of the Hospital and these differences are accounted for as allowances.

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. 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. 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 wrong doing. 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 Medicaid and Medicare programs and the reduction in funding levels could have an adverse effect on the Hospital.

The Hospital has agreements with various Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. Under certain agreements, the HMOs make fee-for-service payments to the Hospital for certain covered services based upon discounted fee schedules.

The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity care patient by reference to the established policies of the Hospital. Essentially, these policies define charity care services as those services for which no payment is anticipated.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 4 - Revenues from Services to Patients and Charity Care (continued)

In assessing a patient's inability to pay, the Hospital and the VNA utilize the generally recognized poverty income levels for the federal government, but also consider certain cases where incurred charges are significant when compared to incomes. Charges related to charity care services are not included in net patient service revenues for consolidated financial reporting purposes.

Note 5 - Retirement Benefit Plans

Retirement Defined Benefit Plan - The Hospital has a defined benefit pension plan (the Plan) covering substantially all employees. The Plan benefits are based on years of service and the employees' compensation during the last five years of covered employment. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future.

The following tables set forth the change in benefit obligations, changes in Plan assets and components of net periodic benefit cost for the Plan:

	<u>2009</u>	<u>2008</u>
Changes in benefit obligations:		
Benefit obligations at beginning of year	\$ 41,381,796	\$ 44,920,922
Service cost	1,304,155	1,522,180
Interest cost	3,034,241	2,804,692
Actuarial loss (gain)	12,260,425	(6,426,106)
Benefits paid	<u>(1,464,515)</u>	<u>(1,439,892)</u>
Benefit obligations at end of year	<u>\$ 56,516,102</u>	<u>\$ 41,381,796</u>
Changes in plan assets:		
Fair value of plan assets at beginning of year	\$ 36,536,416	\$ 45,136,188
Actual return on plan assets	1,018,039	(7,159,880)
Benefits paid	<u>(1,464,515)</u>	<u>(1,439,892)</u>
Fair value of plan assets at end of year	<u>\$ 36,089,940</u>	<u>\$ 36,536,416</u>
Accrued pension liability	<u>\$ (20,426,162)</u>	<u>\$ (4,845,380)</u>

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 5 - Retirement Benefit Plans (continued)

	<u>2009</u>	<u>2008</u>
Components of net periodic benefit cost:		
Service cost	\$ 1,304,155	\$ 1,522,180
Interest cost	3,034,241	2,804,692
Expected return on plan assets	(2,902,452)	(3,769,117)
Recognized net loss	<u>1,003,365</u>	<u>727,982</u>
Net periodic benefit cost	<u>\$ 2,439,309</u>	<u>\$ 1,285,737</u>
Weighted-average assumptions used to determine benefit obligations:	<u>2009</u>	<u>2008</u>
Discount rate	5.54%	7.50%
Future cost of living increase	4.00%	4.00%
Expected return on plan assets	8.00%	8.50%
Weighted-average assumptions used to determine net periodic benefit cost:	<u>2009</u>	<u>2008</u>
Discount rate	7.50%	6.30%
Future cost of living increase	4.00%	4.00%
Expected long-term return on plan assets	8.00%	8.50%

Amounts recorded in unrestricted net assets and not yet amortized as components of net periodic benefit costs total \$9,267,258 as of September 30, 2009. The amortization of these components expected to be recognized in net periodic costs for the year ended September 30, 2010 is \$2,053,101.

The accumulated benefit obligation was \$47,946,048 and \$35,632,862 at September 30, 2009 and 2008, respectively. The plan's measurement date was September 30, 2009 and 2008.

During November 2009, the Hospital approved to freeze its defined benefit pension plan effective January 2010 for all employees. Provisions are being made to "grandfather" those participants in the plan that are sixty years old and have at least ten years of service. All other participants will have their accrued pension benefit frozen. New employees will not be allowed to participate in the pension plan. The estimated impact due to these changes amounts to a reduction of \$8,570,000 to the pension liability which will be recorded in fiscal year 2010, the year the freeze is effective.

The fair values of the Hospital's pension plan assets, which are all held in mutual funds, as of September 30, 2009 are classified as Level 2, as defined in Note 12.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 5 - Retirement Benefit Plans (continued)

Management does not expect to contribute to the Plan during fiscal year 2010.

Information about the expected cash flows from the Plan is as follows:

Estimated future benefit payments:		
2010	\$	1,901,000
2011	\$	2,101,000
2012	\$	2,411,000
2013	\$	2,521,000
2014	\$	2,803,000
Years 2014-2019	\$	17,238,000

Tax Sheltered Annuity - Effective September 30, 1988, the Hospital restated its defined benefit pension plan. The restated pension plan provides for benefits, which are, on average, 6% lower than under the previous plan. Participants were given the option of receiving a pay increase equal to one-half of their calculated reduction in benefits, or contributing that portion into a Tax Sheltered Annuity (TSA) plan. For participants who elected to contribute to the TSA, the Hospital will match the contribution at a rate equal to that contributed by the participant on an annual basis.

The TSA is available to substantially all employees. New participants may elect to contribute up to 20% of pretax compensation not to exceed \$15,500 in calendar year 2009 and 2008 with certain “catch-up” provisions for employees over fifty years of age. These contributions are not matched by the Hospital. The participants are fully vested in their contributions from the date of contribution. Effective January 1, 2003, employees with hire dates after October 1, 1988 are eligible to receive a Hospital TSA matching contribution equal to 1% of their salary provided the employee deposits at least that same amount to their TSA account. This percentage increased to 2% in calendar year 2004 and to 3% beginning in calendar year 2005. Employer contributions to the TSA during fiscal year 2009 and 2008 were \$651,522 and \$650,721 respectively.

Defined Contribution Plan - The VNA sponsors a defined contribution pension plan. Contributions are based on a percentage of employee compensation, as defined by the plan. Total pension expense for the year ended June 30, 2009 and June 30, 2008 amounted to \$43,326 and \$32,122 respectively.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 5 - Retirement Benefit Plans (continued)

Supplemental Executive Retirement Plan - Effective December 21, 2007, the Hospital adopted a SERP under section 457(b) of the Internal Revenue Code of 1986, as amended. The Hospital adopted a second SERP, effective June 30, 2008 under section 457(f) of the Internal Revenue Code of 1986, as amended. The SERP is pursuant to the Employee Retirement Income Security Act of 1974. The SERP has been established to supplement the retirement benefits of eligible employees designated by the Hospital's Board of Directors. The accrued liability relating to the SERP, which is funded annually, amounted to \$1,095,852 and \$1,135,356 as of September 30, 2009 and 2008 respectively. The expenses incurred related to the SERP amounted to \$1,105,105 and \$1,135,356 for the years ended September 30, 2009 and 2008, respectively. Effective October 1, 2009, the SERP will be frozen. Provisions are being made to "grandfather" those participants in the plan that are sixty years old and have at least ten years of service.

Note 6 - Investments

The composition of investments, carried at fair value, is set forth in the following table.

	2009		2008	
	Cost	Market	Cost	Market
Cash and cash equivalents	\$ 2,939,236	\$ 2,939,236	\$ 1,247,129	\$ 1,247,129
Certificates of deposit	4,397,611	4,397,611	2,701,128	2,701,128
Marketable equity securities	201,882	130,537	1,555,354	1,482,031
Corporate and foreign bonds	1,571,335	1,603,233	1,084,437	1,052,895
Mutual funds	735,727	662,038	779,327	801,008
Unit investment trust	60,155	34,805	56,381	53,501
	<u>\$ 9,905,946</u>	<u>\$ 9,767,460</u>	<u>\$ 7,423,756</u>	<u>\$ 7,337,692</u>

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 6 - Investments (continued)

The composition of assets held by trustees restricted to use, carried at fair value, is set forth in the following table.

	2009		2008	
	Cost	Market	Cost	Market
Cash and cash equivalents	\$ 78,453	\$ 78,453	\$ 86,346	\$ 86,346
Marketable equity securities	1,752,608	1,715,900	2,120,108	1,871,527
Corporate and foreign bonds	1,805,145	1,860,096	1,885,460	1,803,057
	\$ 3,636,206	\$ 3,654,449	\$ 4,091,914	\$ 3,760,930

The Hospital held securities that were in an unrealized loss position at September 30, 2009 and 2008, of which several of these securities have been in an unrealized loss position for a period of twelve months or more.

The unrealized losses and market value of securities in an unrealized loss position for less than twelve months and greater than twelve months as of September 30, 2009, are shown below:

	Less than 12 months		12 months or longer	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate and foreign bonds	\$ -	\$ -	\$ 126,751	\$ (4,582)
Marketable equity securities	-	-	201,882	(79,712)
Mutual funds	327,467	(56,356)	-	-
Unit investment trust	-	-	60,155	(25,350)
Total	\$ 327,467	\$ (56,356)	\$ 388,788	\$ (109,644)

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 6 - Investments (continued)

The unrealized losses and market value of fixed maturity securities in an unrealized loss position for less than twelve months and greater than twelve months as of September 30, 2008, are shown below:

	Less than 12 months		12 months or longer	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate and foreign bonds	\$ 268,693	\$ (10,000)	\$ 168,950	\$ (22,684)
Marketable equity securities	408,633	(121,866)	277,653	(131,197)
Unit investment trust	53,501	(2,880)	-	-
 Total	 <u>\$ 730,827</u>	 <u>\$ (134,746)</u>	 <u>\$ 446,603</u>	 <u>\$ (153,881)</u>

The Hospital has the intent and the ability to hold these investments until maturity or until the fair value recovers above the cost basis.

Note 7 - Endowments and Assets Restricted to Use

The Hospital's endowment consists of funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. As required by accounting principles generally accepted in the United States of America, 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 restrictions.

Effective October 1, 2008, the Hospital adopted FASB Staff Position No. 117-1 (FSP 117-1) "*Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*", which was superseded by FASB ASC 958-205, "*Presentation of Financial Statements*." The standards provide guidance on the net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to the UPMIFA and requires additional disclosures for all assets whose use is limited.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 7 - Endowments and Assets Restricted to Use (continued)

The Hospital has interpreted the relevant laws as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. The 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 Board of Directors. The Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the Hospital and 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 the Hospital; and (7) the investment policies of the Hospital.

Temporarily restricted net assets are available for the following purposes as of September 30, 2009 and 2008:

	2009	2008
General purpose	\$ 3,899,436	\$ 3,854,761
Capital expenditures	6,635,184	6,705,183
	\$ 10,534,620	\$ 10,559,944

Permanently restricted net assets as of September 30, 2009 and 2008 are restricted amounts which are to be held in perpetuity, and held in trust by others.

The Hospital is the restricted income beneficiary of assets held by trustee, the income of which is used for general purposes of the Hospital. The total trust assets, as reported by the trustee, had an aggregate market value, based on quoted market prices, at September 30, 2009 and 2008 of \$3,654,449 and \$3,760,930, respectively. These assets have been included in the permanently restricted net assets. Income of \$143,528 and \$174,845 earned on these assets for the years ended September 30, 2009 and 2008, respectively, is included in the consolidated statements of operations within other income.

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 relevant law requires the Hospital to retain as a fund of perpetual duration. Deficiencies of this nature are reported in unrestricted net assets. As of September 30, 2009 and 2008, there were no funds that were below the level required by donor or law.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 7 - Endowments and Assets Restricted to Use (continued)

Return Objectives and Risk Parameters - The Hospital's investment and spending policies for endowment assets attempts to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets.

Strategies Employed for Achieving Objectives - To satisfy its long-term rate-of-return objectives, the Hospital's investment and spending policies for endowment assets attempts to provide preservation of capital, growth after inflation, capital appreciation and compliance with debt covenants. In addition, the objectives include adequate liquidity with limited volatility.

Spending Policy - During its annual budgeting process, the Foundation appropriates donor restricted endowment funds for expenditure in accordance with donor purpose and time restrictions. The Foundation has appropriated \$1,022,024 and \$2,342,745 of funds for expenditure from its temporarily restricted endowment funds for the years ending September 30, 2009 and 2008, respectively.

Changes in endowment and other donor restricted net assets for the year ended September 30, 2009 are as follows:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance at October 1, 2008	\$ 10,559,944	\$ 3,760,930	\$ 14,320,874
Investment return:			
Investment income	309,501	-	309,501
Loss on land held for sale	(400,000)	-	(400,000)
Realized losses on investments	(391,384)	-	(391,384)
Net change in market value	136,132	(106,481)	29,651
Contributions	1,409,754	-	1,409,754
Released for capital acquisitions	(67,303)	-	(67,303)
Expenditures	<u>(1,022,024)</u>	<u>-</u>	<u>(1,022,024)</u>
Balance at September 30, 2009	<u>\$ 10,534,620</u>	<u>\$ 3,654,449</u>	<u>\$ 14,189,069</u>

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 8 - Long-Term Debt

The composition of long-term debt of the Hospital is as follows:

	2009	2008
Bank term loan, payable in monthly installments of \$122,067 amortized over ten years due September 28, 2015; variable interest based on LIBOR plus 1.30% (capped at 5.99% as of September 30, 2009 and 2008)	\$ 7,367,576	\$ 8,358,620
Bank term loan, payable in monthly installments of \$34,025 with a balloon payment of \$516,563 due July 1, 2011; interest fixed at 5.40%	1,153,803	1,489,886
Promissory note, payable in monthly installments of \$2,844 with a balloon payment of \$415,000 due December 11, 2012; interest fixed at 6.50%	435,348	440,981
Promissory note, no interest, payable on December 11, 2009	250,000	250,000
	9,206,727	10,539,487
Less: current maturities	(1,662,730)	(1,332,761)
	\$ 7,543,997	\$ 9,206,726

On September 21, 2005, the Hospital entered into an agreement with TD BankNorth, N.A to provide a term loan in the amount of \$11,000,000 to fund the Hospital's defined benefit pension plan. This loan bears interest at a variable rate, which is reset monthly and is based on LIBOR plus 1.3%. Commencing on October 15, 2005 and continuing on the 15th day of each month through August 15, 2015 and on September 28, 2015, principal and interest of approximately \$122,000 shall be paid in monthly installments. The Hospital obtained a waiver from the bank for certain financial covenants, including liquidity and debt service ratios, which were not met as of September 30, 2009 through October 1, 2010.

Effective September 28, 2005, the Hospital entered into an interest rate swap contract which effectively converts the variable rate on the \$11,000,000 term loan to a fixed rate of 5.99%. This interest rate swap has been designated as a cash flow hedge of the base interest rate. Management has determined that the interest rate swap is highly effective and reflects the changes in the effective portion of the hedge as a change in unrestricted net assets on the accompanying statement of changes in net assets. The ineffective portion of the interest rate swap, if any, is recorded as a non-operating item in the accompanying statement of operations.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 8 - Long-Term Debt (continued)

Effective June 29, 2004, the Hospital entered into an agreement with TD BankNorth, N.A. (formerly Banknorth) to provide a term loan in the amount of \$2,724,825. In connection with the term loan, the Hospital has a revolving credit facility of \$5,250,000. The credit facility with TD BankNorth, N.A. bears interest at the bank's prime lending rates minus 1%. The revolving credit facility may be revoked at the bank's option. There was \$0 and \$2,070,000 outstanding under this line of credit as of September 30, 2009 and 2008.

On December 11, 2006, the Hospital entered into a mortgage agreement in the amount of \$450,000 for the purchase of land and a building. Principal and interest are paid monthly in the amount of \$2,844. This loan bears interest at 6.50%. All amounts outstanding on December 11, 2012, which approximate \$415,000, are due to be paid in full.

In conjunction with the above mortgage the Hospital entered into a demand note in the amount of \$250,000, which is due to be paid in full on December 11, 2009. No interest is charged on the loan. The note has not been discounted for the imputed interest as it is immaterial to the overall financial statements.

Substantially, all assets owned by the Hospital are pledged as collateral for the term loans and revolving credit facility.

The aggregate annual maturities of long-term debt for the next five fiscal years and thereafter are as follows:

Maturities of long-term debt:	
2010	\$ 1,662,730
2011	1,922,369
2012	1,606,864
2013	1,258,608
2014	1,336,092
Thereafter	<u>1,420,064</u>
	<u><u>\$ 9,206,727</u></u>

Interest paid in 2009 and 2008 was \$701,705 and \$784,483 respectively.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 9 - Promises to Give

	<u>2009</u>	<u>2008</u>
Unconditional promises to give before discount and allowance for uncollectible pledges	\$ 646,352	\$ 1,303,902
Less: discount and allowance for uncollectible pledges	<u>(71,606)</u>	<u>(160,799)</u>
	<u>\$ 574,746</u>	<u>\$ 1,143,103</u>
Amounts due in:		
Less than one year	\$ 231,484	\$ 820,034
One to five years	<u>414,868</u>	<u>483,868</u>
Total	<u>\$ 646,352</u>	<u>\$ 1,303,902</u>

A discount rate of 5% was used in 2009 and 2008.

Note 10 - Functional Expenses

The Hospital and its subsidiaries provide healthcare services to residents within its geographic location. Expenses related to providing these services are as follows:

	<u>2009</u>	<u>2008</u>
Patient care services	\$ 72,627,481	\$ 69,620,288
General and administrative	29,794,950	29,115,527
Fundraising	<u>794,641</u>	<u>1,512,343</u>
	<u>\$ 103,217,072</u>	<u>\$ 100,248,158</u>

Note 11 - Commitments and Contingencies

Litigation - The Hospital is a defendant in various legal actions arising during the normal course of its operations, the final outcome of which cannot presently be determined. Hospital management is of the opinion that eventual liability, if any, with respect to all of these matters will not have a material adverse effect on the Hospital's financial position.

Union Membership - Approximately 20% of the Hospital's employees are union employees who are covered under the terms of a collective bargaining agreement which expires on December 31, 2011.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 11 - Commitments and Contingencies (continued)

Workers' Compensation Insurance - The Hospital is self-insured for workers' compensation benefits. In connection with being self-insured, the Hospital has an outstanding unused letter of credit aggregating approximately \$250,000 at September 30, 2009 and 2008. Liabilities have been accrued at September 30, 2009 and 2008 based on expected future payments pertaining to such years.

Operating Leases - The Hospital leases various equipment and facilities under operating leases expiring at various dates through 2014 and thereafter. Total rental expense charged to operations amounted to \$1,250,544 and \$1,168,414 in 2009 and 2008, respectively.

Future minimum payments required under noncancellable operating leases with initial or remaining terms of one year or more consisted of the following as of September 30, 2009:

	Operating Leases	Building Rentals
For the year ended September 30:		
2010	\$ 203,484	\$ 370,841
2011	81,521	307,427
2012	29,967	159,997
2013	23,814	154,398
2014 and thereafter	8,175	70,333
	<u> </u>	<u> </u>
Total minimum lease payments	<u>\$ 346,961</u>	<u>\$ 1,062,996</u>

Note 12 - Fair Values

Effective October 1, 2008 the Hospital adopted FASB Codification 820 "*Fair Value Measurements and Disclosures*," which defines fair value, establishes framework for measuring fair value in accounting principles generally accepted in the United States and expands disclosures about fair value measurements. FASB Codification 820 does not require any new fair value measurements but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. The new definition of fair value focuses on the price that would be received to sell the asset or paid to transfer the liability, which is referred to as the exit price. The standards provide guidance on how to measure fair value, when required, under existing accounting standards and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, 2 and 3).

Level 1 - Observable inputs that reflect quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access at the measurement date.

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 12 - Fair Values (continued)

Level 2 - Observable inputs, other than quoted prices included in Level 1, for the asset or liability or prices for similar assets and liabilities.

Level 3 - Unobservable inputs reflecting the Hospital's estimates of the assumptions that market participants could use in pricing the asset or liability (including assumptions about risk).

Management determines the appropriate classification of its investments in all securities at the time of purchase and re-evaluates such determination at each balance sheet date. The Hospital has classified its investments in available for sale securities as Level 1, 2 and 3 as follows:

	<u>Total</u>	<u>Quoted Prices in Active Markets (Level 1)</u>	<u>Significant Observable Inputs (Level 2)</u>
Cash and cash equivalents	\$ 3,017,689	\$ 3,017,689	\$ -
Certificates of deposit	4,397,611	4,397,611	
Marketable equity securities	1,846,437	1,846,437	-
Corporate and foreign bonds	3,463,329	1,618,675	1,844,654
Mutual funds	662,038	662,038	
Unit investment trusts	34,805	-	34,805
	<u>34,805</u>	<u>-</u>	<u>34,805</u>
Total	<u>\$ 13,421,909</u>	<u>\$ 11,542,450</u>	<u>\$ 1,879,459</u>

The following table provides a summary of changes in the fair value of the Hospital's interest rate swap liability classified as Level 3 and carried within accounts payable and accrued expenses within the consolidated balance sheets, for the year ended September 30, 2009:

Beginning balance at October 1, 2008	\$ 226,260
Total realized and unrealized losses:	
Included in net assets	<u>360,318</u>
Ending balance at September 30, 2009	<u>\$ 586,578</u>

The New Milford Hospital, Incorporated and Subsidiaries
Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2009 and 2008

Note 12 - Fair Values (continued)

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

Cash and Cash Equivalents - The carrying amount reported in the accompanying consolidated balance sheets for cash and cash equivalents approximates its fair value.

Restricted Cash - The carrying amount reported in the accompanying consolidated balance sheets for restricted cash approximates its fair value.

Long-Term Debt - Fair values of the Hospital's long-term debt, are based on current borrowing rates for similar types of debt, using discounted cash flow analyses.

Interest Rate Swap Liability - The Hospital has classified its swap contract liability as of September 30, 2009 as a Level 3 instrument and measures the fair value using information provided by TD Securities. The fair value estimate considers the underlying notional debt principal amounts and the current interest rates paid by the Hospital and TD Securities under the swap contract.

Note 13 - Subsequent and Other Events

Subsequent events have been evaluated through March 9, 2010, the date through which procedures were performed to prepare the consolidated financial statements for issuance.

During September 2009, the Hospital announced plans of exploring an affiliation with Danbury Hospital during fiscal year 2010 to provide a more coordinated and enhanced scope of clinical services for the populations of both service areas with the goal of improved access and quality.

The Hospital approved to freeze its SERP, as of October 1, 2009, as described in Note 5.

During November 2009, the Hospital approved to freeze its defined benefit pension plan, as described in Note 5.

The New Milford Hospital, Incorporated and Subsidiaries
Consolidating Balance Sheet
September 30, 2009

	The New Milford Hospital, Inc.	New Milford Hospital Foundation, Inc.	New Milford Visiting Nurse Association, Inc.	Total	Eliminations	The New Milford Hospital Inc.
Assets						
Current assets:						
Cash and cash equivalents	\$ 2,513,911	\$ 175,567	\$ 781,176	\$ 3,470,654	\$ -	\$ 3,470,654
Restricted cash for SERP	1,095,852	-	-	1,095,852	-	1,095,852
Short-term investments	195,420	-	-	195,420	-	195,420
Accounts receivable, net	10,792,628	-	536,569	11,329,197	-	11,329,197
Pledges receivable, current	-	223,358	-	223,358	-	223,358
Land held for sale	-	1,600,000	-	1,600,000	-	1,600,000
Prepaid expenses	2,935,422	-	72,028	3,007,450	-	3,007,450
Other receivables	515,117	30,128	-	545,245	-	545,245
Inventories	2,035,077	-	-	2,035,077	-	2,035,077
Due from affiliates	46,292	-	-	46,292	(46,292)	-
Total current assets	20,129,719	2,029,053	1,389,773	23,548,545	(46,292)	23,502,253
Other assets:						
Investments (VNA)	-	-	1,539,224	1,539,224	-	1,539,224
Investments (Foundation)	-	8,228,236	-	8,228,236	-	8,228,236
Assets held by trustees - restricted to use	-	3,654,449	-	3,654,449	-	3,654,449
Pledges receivable, long-term	-	351,388	-	351,388	-	351,388
Investment in Foundation	14,189,069	-	-	14,189,069	(14,189,069)	-
Investment in VNA	2,881,984	-	-	2,881,984	(2,881,984)	-
Other assets	804,444	-	-	804,444	-	804,444
	17,875,497	12,234,073	1,539,224	31,648,794	(17,071,053)	14,577,741
Property, plant and equipment:						
Land and land improvements	1,546,857	-	-	1,546,857	-	1,546,857
Buildings	46,125,430	-	-	46,125,430	-	46,125,430
Equipment	43,856,432	-	556,658	44,413,090	-	44,413,090
Construction in progress	668,678	-	-	668,678	-	668,678
	92,197,397	-	556,658	92,754,055	-	92,754,055
Less: accumulated depreciation	(60,489,384)	-	(367,252)	(60,856,636)	-	(60,856,636)
Net property, plant and equipment	31,708,013	-	189,406	31,897,419	-	31,897,419
Total assets	\$ 69,713,229	\$ 14,263,126	\$ 3,118,403	\$ 87,094,758	\$ (17,117,345)	\$ 69,977,413

See accompanying Independent Auditors' Report

The New Milford Hospital, Incorporated and Subsidiaries
Consolidating Balance Sheet (continued)
September 30, 2009

	The New Milford Hospital, Inc.	New Milford Hospital Foundation, Inc.	New Milford Visiting Nurse Association, Inc.	Total	Eliminations	The New Milford Hospital Inc.
Liabilities and Net Assets						
Current liabilities:						
Bank line of credit	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Accounts payable and accrued expenses	7,756,646	27,765	35,431	7,819,842	-	7,819,842
Accrued salaries, wages and fees	2,869,848	-	116,341	2,986,189	-	2,986,189
Amount due for SERP liability	1,095,852	-	-	1,095,852	-	1,095,852
Due to third party payers	2,305,128	-	84,647	2,389,775	-	2,389,775
Due to affiliates	-	46,292	-	46,292	(46,292)	-
Current portion of long-term debt	1,662,730	-	-	1,662,730	-	1,662,730
Total current liabilities	15,690,204	74,057	236,419	16,000,680	(46,292)	15,954,388
Other accrued expenses	2,284,464	-	-	2,284,464	-	2,284,464
Accrued pension liability	20,426,162	-	-	20,426,162	-	20,426,162
Long-term debt, less current portion	7,543,997	-	-	7,543,997	-	7,543,997
Total liabilities	45,944,827	74,057	236,419	46,255,303	(46,292)	46,209,011
Net assets:						
Unrestricted	13,080,008	-	2,881,984	15,961,992	(6,382,659)	9,579,333
Temporarily restricted	7,033,945	10,534,620	-	17,568,565	(7,033,945)	10,534,620
Permanently restricted	3,654,449	3,654,449	-	7,308,898	(3,654,449)	3,654,449
Total net assets	23,768,402	14,189,069	2,881,984	40,839,455	(17,071,053)	23,768,402
Total liabilities and net assets	\$ 69,713,229	\$ 14,263,126	\$ 3,118,403	\$ 87,094,758	\$ (17,117,345)	\$ 69,977,413

See accompanying Independent Auditors' Report

The New Milford Hospital, Incorporated and Subsidiaries
Consolidating Balance Sheet
September 30, 2008

	The New Milford Hospital, Inc.	New Milford Hospital Foundation, Inc.	New Milford Visiting Nurse Association, Inc.	Total	Eliminations	The New Milford Hospital Inc.
Assets						
Current assets:						
Cash and cash equivalents	\$ 2,003,448	\$ 3,139,253	\$ 507,188	\$ 5,649,889	\$ -	\$ 5,649,889
Restricted cash for SERP	1,135,356	-	-	1,135,356	-	1,135,356
Short-term investments	830,159	-	-	830,159	-	830,159
Accounts receivable, net	10,991,250	-	683,668	11,674,918	-	11,674,918
Pledges receivable, current	-	792,478	-	792,478	-	792,478
Land held for sale	-	2,000,000	-	2,000,000	-	2,000,000
Prepaid expenses	2,261,301	-	81,234	2,342,535	-	2,342,535
Other receivables	871,559	5,025	-	876,584	-	876,584
Inventories	2,090,275	-	-	2,090,275	-	2,090,275
Due from affiliates	1,352,988	-	-	1,352,988	(1,352,988)	-
Total current assets	21,536,336	5,936,756	1,272,090	28,745,182	(1,352,988)	27,392,194
Other assets:						
Investments	-	-	1,693,105	1,693,105	-	1,693,105
Investments - Board designated	-	5,644,587	-	5,644,587	-	5,644,587
Assets held by trustees - restricted to use	-	3,760,930	-	3,760,930	-	3,760,930
Pledges receivable, long-term	-	350,625	-	350,625	-	350,625
Investment in Foundation	14,320,874	-	-	14,320,874	(14,320,874)	-
Investment in VNA	2,822,892	-	-	2,822,892	(2,822,892)	-
Other assets	1,448,625	-	-	1,448,625	-	1,448,625
	18,592,391	9,756,142	1,693,105	30,041,638	(17,143,766)	12,897,872
Property, plant and equipment:						
Land and land improvements	1,546,857	-	-	1,546,857	-	1,546,857
Buildings	45,307,482	-	-	45,307,482	-	45,307,482
Equipment	42,815,221	-	556,658	43,371,879	-	43,371,879
	89,669,560	-	556,658	90,226,218	-	90,226,218
Less: accumulated depreciation	(55,543,307)	-	(324,806)	(55,868,113)	-	(55,868,113)
Net property, plant and equipment	34,126,253	-	231,852	34,358,105	-	34,358,105
Total assets	\$ 74,254,980	\$ 15,692,898	\$ 3,197,047	\$ 93,144,925	\$ (18,496,754)	\$ 74,648,171

See accompanying Independent Auditors' Report

The New Milford Hospital, Incorporated and Subsidiaries
Consolidating Balance Sheet (continued)
September 30, 2008

	The New Milford Hospital, Inc.	New Milford Hospital Foundation, Inc.	New Milford Visiting Nurse Association, Inc.	Total	Eliminations	The New Milford Hospital Inc.
Liabilities and Net Assets						
Current liabilities:						
Bank line of credit	\$ 2,070,000	\$ -	\$ -	\$ 2,070,000	\$ -	\$ 2,070,000
Accounts payable and accrued expenses	6,301,413	19,036	159,943	6,480,392	-	6,480,392
Accrued salaries, wages and fees	2,694,149	-	129,565	2,823,714	-	2,823,714
Amount due for SERP liability	1,135,356	-	-	1,135,356	-	1,135,356
Due to third party payers	1,217,686	-	84,647	1,302,333	-	1,302,333
Due to affiliates	-	1,352,988	-	1,352,988	(1,352,988)	-
Current portion of long-term debt	1,332,761	-	-	1,332,761	-	1,332,761
Total current liabilities	14,751,365	1,372,024	374,155	16,497,544	(1,352,988)	15,144,556
Other accrued expenses	1,886,628	-	-	1,886,628	-	1,886,628
Accrued pension liability	4,845,380	-	-	4,845,380	-	4,845,380
Long-term debt, less current portion	9,206,726	-	-	9,206,726	-	9,206,726
Total liabilities	30,690,099	1,372,024	374,155	32,436,278	(1,352,988)	31,083,290
Net assets:						
Unrestricted	32,744,682	-	2,822,892	35,567,574	(6,323,567)	29,244,007
Temporarily restricted	7,059,269	10,559,944	-	17,619,213	(7,059,269)	10,559,944
Permanently restricted	3,760,930	3,760,930	-	7,521,860	(3,760,930)	3,760,930
Total net assets	43,564,881	14,320,874	2,822,892	60,708,647	(17,143,766)	43,564,881
 Total liabilities and net assets	 \$ 74,254,980	 \$ 15,692,898	 \$ 3,197,047	 \$ 93,144,925	 \$ (18,496,754)	 \$ 74,648,171

See accompanying Independent Auditors' Report

The New Milford Hospital, Incorporated and Subsidiaries
Consolidating Statement of Operations
For the Year Ended September 30, 2009

	The New Milford Hospital Inc.	New Milford Hospital Foundation, Inc.	New Milford Visiting Nurse Association, Inc.	Total	Eliminations	The New Milford Hospital Inc.
Operating revenues:						
Net patient revenues	\$ 89,646,041	\$ -	\$ 3,260,888	\$ 92,906,929	\$ -	\$ 92,906,929
Transfers from Foundation for program expenses	150,000	-	-	150,000	(150,000)	-
Other operating revenues	3,430,001	1,022,024	357,898	4,809,923	-	4,809,923
Total operating revenues	93,226,042	1,022,024	3,618,786	97,866,852	(150,000)	97,716,852
Operating expenses:						
Salaries and wages	39,922,131	360,412	2,588,937	42,871,480	-	42,871,480
Employee benefits	13,279,342	69,121	-	13,348,463	-	13,348,463
Supplies and other	36,709,448	442,491	960,912	38,112,851	-	38,112,851
Depreciation and amortization	4,946,076	-	42,446	4,988,522	-	4,988,522
Provision for bad debts	3,220,173	-	-	3,220,173	-	3,220,173
Interest	675,584	-	-	675,584	-	675,584
Hospital program support	-	150,000	-	150,000	(150,000)	-
Total operating expenses	98,752,754	1,022,024	3,592,295	103,367,073	(150,000)	103,217,073
Loss from operations	(5,526,712)	-	26,491	(5,500,221)	-	(5,500,221)
Other income:						
Non-operating gains	113,996	-	48,123	162,119	-	162,119
Change in equity of VNA	247,646	-	-	247,646	(247,646)	-
Contributions	-	-	173,032	173,032	-	173,032
Excess of revenues (under) over expenses	\$ (5,165,070)	\$ -	\$ 247,646	\$ (4,917,424)	\$ (247,646)	\$ (5,165,070)

See accompanying Independent Auditors' Report

The New Milford Hospital, Incorporated and Subsidiaries
Consolidating Statement of Operations
For the Year Ended September 30, 2008

	The New Milford Hospital Inc.	New Milford Hospital Foundation, Inc.	New Milford Visiting Nurse Association, Inc.	Total	Eliminations	The New Milford Hospital Inc.
Operating revenues:						
Net patient revenues	\$ 89,127,772	\$ -	\$ 2,986,126	\$ 92,113,898	\$ -	\$ 92,113,898
Transfers from Foundation for program expenses	1,068,000	-	-	1,068,000	(1,068,000)	-
Contributions for cancer center	509,407	-	-	509,407	(375,000)	134,407
Other operating revenues	3,667,421	2,342,745	333,738	6,343,904	-	6,343,904
Total operating revenues	94,372,600	2,342,745	3,319,864	100,035,209	(1,443,000)	98,592,209
Operating expenses:						
Salaries and wages	37,942,222	317,685	2,352,249	40,612,156	-	40,612,156
Employee benefits	11,788,347	75,978	-	11,864,325	-	11,864,325
Supplies and other	36,744,470	506,082	1,049,434	38,299,986	-	38,299,986
Depreciation and amortization	4,944,502	-	35,087	4,979,589	-	4,979,589
Provision for bad debts	3,730,727	-	30,677	3,761,404	-	3,761,404
Interest	730,698	-	-	730,698	-	730,698
Hospital program support	-	1,443,000	-	1,443,000	(1,443,000)	-
Total operating expenses	95,880,966	2,342,745	3,467,447	101,691,158	(1,443,000)	100,248,158
Loss from operations	(1,508,366)	-	(147,583)	(1,655,949)	-	(1,655,949)
Other income:						
Non-operating gains	150,632	-	105,741	256,373	-	256,373
Change in equity of VNA	206,789	-	-	206,789	(206,789)	-
Contributions	-	-	248,631	248,631	-	248,631
Excess of revenues (under) over expenses	\$ (1,150,945)	\$ -	\$ 206,789	\$ (944,156)	\$ (206,789)	\$ (1,150,945)

See accompanying Independent Auditors' Report

The New Milford Hospital, Incorporated and Subsidiaries
Consolidating Statement of Changes in Net Assets
For the Year Ended September 30, 2009

	The New Milford Hospital Inc.	New Milford Hospital Foundation, Inc.	New Milford Visiting Nurse Association, Inc.	Total	Eliminations	The New Milford Hospital Inc.
Unrestricted net assets:						
Excess of revenues (under) over expenses	\$ (5,165,070)	\$ -	\$ 247,646	\$ (4,917,424)	\$ (247,646)	\$ (5,165,070)
Net assets released for capital acquisitions	67,303	-	-	67,303	-	67,303
Net unrealized losses on interest rate swap contract	(360,318)	-	-	(360,318)	-	(360,318)
Net unrealized losses on investments	(188,554)	-	(188,554)	(377,108)	188,554	(188,554)
Pension changes other than net periodic benefit costs	(13,148,781)	-	-	(13,148,781)	-	(13,148,781)
Cumulative effect of a change in accounting principle	(869,254)	-	-	(869,254)	-	(869,254)
Change in unrestricted net assets	(19,664,674)	-	59,092	(19,605,582)	(59,092)	(19,664,674)
Temporarily restricted net assets:						
Transfers to The New Milford Hospital, Inc.	-	(67,303)	-	(67,303)	67,303	-
Contributions	-	1,385,404	-	1,385,404	-	1,385,404
Investment income	-	309,501	-	309,501	-	309,501
Loss on land held for sale	-	(400,000)	-	(400,000)	-	(400,000)
Net realized losses on investments	-	(391,384)	-	(391,384)	-	(391,384)
Net assets released for operations	-	(1,022,024)	-	(1,022,024)	-	(1,022,024)
Net assets released from restrictions - capital	-	-	-	-	(67,303)	(67,303)
Special events	-	24,350	-	24,350	-	24,350
Net unrealized gains on investments	-	136,132	-	136,132	-	136,132
Change in equity in net assets of the Foundation	(25,324)	-	-	(25,324)	25,324	-
Change in temporarily restricted net assets	(25,324)	(25,324)	-	(50,648)	25,324	(25,324)
Permanently restricted net assets:						
Net unrealized losses on investments held in trust by others	(106,481)	(106,481)	-	(212,962)	106,481	(106,481)
Change in permanently restricted net assets	(106,481)	(106,481)	-	(212,962)	106,481	(106,481)
Change in net assets	(19,796,479)	(131,805)	59,092	(19,869,192)	72,713	(19,796,479)
Net assets, beginning of year	43,564,881	14,320,874	2,822,892	60,708,647	(17,143,766)	43,564,881
Net assets, end of year	\$ 23,768,402	\$ 14,189,069	\$ 2,881,984	\$ 40,839,455	\$ (17,071,053)	\$ 23,768,402

See accompanying Independent Auditors' Report

The New Milford Hospital, Incorporated and Subsidiaries
Consolidating Statement of Changes in Net Assets
For the Year Ended September 30, 2008

	The New Milford Hospital Inc.	New Milford Hospital Foundation, Inc.	New Milford Visiting Nurse Association, Inc.	Total	Eliminations	The New Milford Hospital Inc.
Unrestricted net assets:						
Excess of revenues over (under) expenses	\$ (1,150,945)	\$ -	\$ 206,789	\$ (944,156)	\$ (206,789)	\$ (1,150,945)
Net assets released for capital acquisitions	654,578	-	-	654,578	(654,578)	-
Net asset transfer	-	-	-	-	654,578	654,578
Net unrealized losses on interest rate swap contract	(269,835)	-	-	(269,835)	-	(269,835)
Net unrealized losses on investments	(86,592)	-	(86,592)	(173,184)	86,592	(86,592)
Pension changes other than net periodic benefit costs	(3,774,909)	-	-	(3,774,909)	-	(3,774,909)
Change in unrestricted net assets	(4,627,703)	-	120,197	(4,507,506)	(120,197)	(4,627,703)
Temporarily restricted net assets:						
Transfers to The New Milford Hospital, Inc.	-	(654,578)	-	(654,578)	654,578	-
Contributions	-	4,188,023	-	4,188,023	-	4,188,023
Investment income	-	409,689	-	409,689	-	409,689
Net realized losses on investments	-	(87,560)	-	(87,560)	-	(87,560)
Net assets released for operations	-	(1,967,745)	-	(1,967,745)	-	(1,967,745)
Net assets released from restrictions - capital	-	-	-	-	(654,578)	(654,578)
Special events	-	73,425	-	73,425	-	73,425
Net unrealized losses on investments	-	(393,456)	-	(393,456)	-	(393,456)
Change in equity in net assets of the Foundation	1,567,798	-	-	1,567,798	(1,567,798)	-
Change in temporarily restricted net assets	1,567,798	1,567,798	-	3,135,596	(1,567,798)	1,567,798
Permanently restricted net assets:						
Net unrealized losses on investments held in trust by others	(852,869)	(852,869)	-	(1,705,738)	852,869	(852,869)
Change in permanently restricted net assets	(852,869)	(852,869)	-	(1,705,738)	852,869	(852,869)
Change in net assets	(3,912,774)	714,929	120,197	(3,077,648)	(835,126)	(3,912,774)
Net assets, beginning of year	47,477,655	13,605,945	2,702,695	63,786,295	(16,308,640)	47,477,655
Net assets, end of year	\$ 43,564,881	\$ 14,320,874	\$ 2,822,892	\$ 60,708,647	\$ (17,143,766)	\$ 43,564,881

See accompanying Independent Auditors' Report