

**Lawrence & Memorial
Corporation and Subsidiaries**
Consolidated Financial Statements
September 30, 2009 and 2008

Lawrence & Memorial Corporation and Subsidiaries

Index

September 30, 2009 and 2008

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Report of Independent Auditors

To the Board of Directors of
Lawrence & Memorial Corporation

In our opinion, based on our audits and the report of other auditors, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in net assets, and cash flows present fairly, in all material respects, the financial position of Lawrence & Memorial Corporation (the "Corporation") and subsidiaries at September 30, 2009 and 2008 and the results of their operations, of their changes in net assets, and of their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Corporation'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 Visiting Nurses Association ("VNA") of Southeastern Connecticut, Inc., a wholly-owned subsidiary, whose statements as of September 30, 2009 and 2008 reflect total net assets constituting 5.0% and 4.9%, respectively, and total net revenues constituting 3.8% and 5.0%, respectively, of the related consolidated totals. Those statements have been audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to data included for VNA of Southeastern Connecticut, Inc., is based solely on the reports of the other auditors. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information, on pages 23 through 28, is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual organizations. Accordingly, we do not express an opinion on the financial position, results of operations, and changes in net assets, of the individual organizations. However, the consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, based on our audits and the report of other auditors, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

As discussed in Note 1 to the accompanying financial statements, the Corporation changed the manner in which it accounts for the classification of its endowment funds in 2009.

PricewaterhouseCoopers LLP

January 8, 2010

Lawrence & Memorial Corporation and Subsidiaries
Consolidated Balance Sheets
September 30, 2009 and 2008

	2009	2008
Assets		
Current assets		
Cash and cash equivalents	\$ 30,049,949	\$ 25,182,706
Investments	141,225,546	138,861,705
Patient accounts receivable, net of allowance for doubtful accounts of \$6,674,799 and \$8,101,192, respectively	29,961,635	36,586,333
Other receivables	6,543,410	4,688,417
Inventories	3,506,113	3,357,049
Due from affiliates	24,500	24,501
Prepaid expenses and other current assets	2,538,001	2,026,185
Debt service fund	1,295,094	1,294,037
Total current assets	215,144,248	212,020,933
Assets limited as to use		
Cash	177,710	210,229
Construction fund	6,170	6,127
Investments held in trust	12,678,851	12,999,368
Endowment investments	20,488,707	21,539,140
Funds held in trust by others	5,611,568	5,783,882
Contributions receivable	1,327,113	681,252
Fund held in escrow by agreement with State of Connecticut Health and Educational Facilities Authority and trustees	7,159,610	7,341,007
Total assets limited as to use	47,449,729	48,561,005
Deferred financing costs and other assets, net	2,779,069	2,989,857
Property, plant and equipment, net	109,741,869	104,689,555
	\$ 375,114,915	\$ 368,261,350
Liabilities and Net Assets		
Current liabilities		
Accounts payable	\$ 15,477,043	\$ 19,368,036
Accrued vacation and sick pay	10,641,451	10,165,897
Salaries, wages, payroll taxes and amounts withheld from employees	4,184,333	3,700,920
Due to affiliates	718,757	422,911
Due to third party payors	9,222,736	8,126,913
Other current liabilities	364,053	398,376
Current portion of long-term debt	2,674,572	2,548,684
Total current liabilities	43,282,945	44,731,737
Accrued pension and other postretirement benefits	43,035,284	20,631,280
Other liabilities	12,202,253	11,764,379
Long-term debt less current portion	65,938,421	68,601,321
Total liabilities	164,458,903	145,728,717
Net assets		
Unrestricted (as reclassified (Note 1))	187,324,944	198,759,380
Temporarily restricted (as reclassified (Note 1))	17,758,955	18,138,029
Permanently restricted	5,572,113	5,635,224
Total net assets	210,656,012	222,532,633
	\$ 375,114,915	\$ 368,261,350

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

Lawrence & Memorial Corporation and Subsidiaries
Consolidated Statements of Operations
Years Ended September 30, 2009 and 2008

	2009	2008
Unrestricted revenues, gains and other support:		
Net revenues from services to patients	\$ 295,154,990	\$ 279,109,234
Other operating revenues	17,579,868	19,822,014
Net assets released from restriction	460,320	422,147
Total unrestricted revenues, gains and other support	<u>313,195,178</u>	<u>299,353,395</u>
Expenses:		
Salaries and wages	146,830,700	138,981,242
Employee benefits	38,489,945	35,795,053
Supplies	32,245,723	30,117,327
Purchased services	22,007,293	22,102,969
Bad debts	17,657,789	18,131,375
Other	30,368,297	30,465,084
Interest	2,673,379	3,480,601
Depreciation and amortization	16,403,646	14,667,108
Total expenses	<u>306,676,772</u>	<u>293,740,759</u>
Income from operations	6,518,406	5,612,636
Non-operating gains/(losses)		
Unrestricted investment income	266,039	322,958
(Loss)/income from investments	(983,287)	4,689,581
Realized losses on investments deemed other than temporarily impaired	(645,291)	(3,234,968)
Total non-operating (losses)/gains	<u>(1,362,539)</u>	<u>1,777,571</u>
Excess of revenues over expenses	<u>5,155,867</u>	<u>7,390,207</u>
Net unrealized gains/(losses) on investments	5,217,924	(22,613,479)
Net assets released from restrictions used for purchase of property, plant and equipment	385,879	1,365,403
Pension - related changes other than periodic pension costs	(22,254,106)	(5,290,651)
Donated equipment	60,000	1,214,894
Decrease in unrestricted net assets	<u>\$ (11,434,436)</u>	<u>\$ (17,933,626)</u>

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

Lawrence & Memorial Corporation and Subsidiaries
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2009 and 2008

	2009	2008
Unrestricted net assets		
Excess of revenues over expenses	\$ 5,155,867	\$ 7,390,207
Net unrealized gains/(losses) on investments	5,217,924	(22,613,479)
Net assets released from restrictions used for purchase of property, plant and equipment	385,879	1,365,403
Pension - related changes other than periodic pension costs	(22,254,106)	(5,290,651)
Donated equipment	60,000	1,214,894
Decrease in unrestricted net assets	<u>(11,434,436)</u>	<u>(17,933,626)</u>
Beginning of year unrestricted net assets	198,759,380	230,195,738
Cumulative effect of change in accounting principle (Note 1)	-	(13,502,157)
Beginning of year unrestricted net assets, as reclassified	<u>198,759,380</u>	<u>216,693,006</u>
End of year unrestricted net assets, as reclassified	<u>\$ 187,324,944</u>	<u>\$ 198,759,380</u>
Temporarily restricted net assets		
Income from investments	\$ 445,602	\$ 427,612
Net assets released from restrictions	(846,199)	(1,787,550)
Contributions received	709,585	429,886
Change in value of irrevocable trusts	(108,819)	(860,363)
Net realized and unrealized losses on investments	<u>(579,243)</u>	<u>(3,708,241)</u>
Decrease in temporarily restricted net assets	<u>(379,074)</u>	<u>(5,498,656)</u>
Beginning of year temporarily restricted net assets	18,138,029	10,133,953
Cumulative effect of change in accounting principal (Note 1)	-	13,502,157
Beginning of year temporarily restricted net assets, as reclassified	<u>18,138,029</u>	<u>23,636,685</u>
End of year temporarily restricted net assets, as reclassified	<u>\$ 17,758,955</u>	<u>\$ 18,138,029</u>
Permanently restricted net assets		
Change in value of funds held in trust by others	<u>\$ (63,111)</u>	<u>\$ (611,219)</u>
Decrease in permanently restricted net assets	<u>(63,111)</u>	<u>(611,219)</u>
Beginning of year permanently restricted net assets	<u>5,635,224</u>	<u>6,246,443</u>
End of year permanently restricted net assets	<u>\$ 5,572,113</u>	<u>\$ 5,635,224</u>
Decrease in net assets	<u>\$ (11,876,621)</u>	<u>\$ (24,043,501)</u>

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

Lawrence & Memorial Corporation and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities		
Change in net assets	\$ (11,876,621)	\$ (24,043,501)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	16,403,646	14,667,108
Receipt of contributed securities	(125,724)	(1,487,646)
Net unrealized and realized (gains)/losses on investments	(6,569,088)	26,722,010
Realized loss on other than temporarily impaired investments	645,291	3,234,968
Provision for bad debts	17,657,789	18,131,375
Decrease in funds held in trust by others	172,314	1,463,327
(Increase) in contributions receivable	(645,861)	(528,527)
Other changes in net assets		
Restricted contributions and investment income	-	2,865
Changes in other operating accounts		
Patient accounts receivable, net	(11,033,091)	(12,989,038)
Other receivables, net	(1,854,993)	862,533
Inventories	(149,064)	(210,013)
Prepaid expenses and other current assets	(511,816)	(466,973)
Deferred financing costs and other assets	210,788	210,788
Accounts payable	(2,104,854)	5,891,872
Accrued vacation and sick pay	475,554	717,647
Salaries, wages, payroll taxes and amounts withheld from employees	483,413	(81,218)
Due to affiliates	295,846	228,282
Due from affiliates	1	(1)
Due to third party payors	1,095,823	3,317,903
Pension, postretirement and other liabilities	22,807,555	4,756,861
Net cash provided by operating activities	<u>25,376,908</u>	<u>40,400,622</u>
Cash flows from investing activities		
Purchase of property, plant and equipment, net	(23,173,702)	(23,446,532)
Purchases of investments	(108,381,734)	(201,832,408)
Sales of investments	113,345,116	186,447,325
(Increase)/decrease in debt service fund	(1,057)	14,523
Decrease in funds held in escrow	181,397	88,239
Net cash used in investing activities	<u>(17,904,256)</u>	<u>(38,728,853)</u>
Cash flows from financing activities		
Contributions restricted for long term initiatives	(68,397)	(1,335,189)
Principal payments of long term debt	(2,537,012)	(2,415,682)
Net cash used in financing activities	<u>(2,605,409)</u>	<u>(3,750,871)</u>
Net increase/(decrease) in cash and cash equivalents	4,867,243	(2,079,105)
Cash and cash equivalents		
Beginning of year	25,182,706	27,261,811
End of year	<u>\$ 30,049,949</u>	<u>\$ 25,182,706</u>
Supplemental disclosure of non cash activities		
Construction in process included in accounts payable	<u>\$ 1,317,209</u>	<u>\$ 3,103,348</u>
Asset retirement obligation	<u>\$ 604,532</u>	<u>\$ 576,542</u>
Contributed securities	<u>\$ 125,724</u>	<u>\$ 1,487,646</u>

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

Lawrence & Memorial Corporation and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

1. Significant Accounting Policies and Organization

Organization

Lawrence & Memorial Corporation (the "Corporation") is a not-for-profit organization incorporated under the Non-Stock Corporation Act of the State of Connecticut. The Corporation is organized exclusively for public welfare, charitable, scientific, literary and education purposes, including the furtherance of the welfare, programs and activities of Lawrence & Memorial Hospital (the "Hospital"), a non-profit organization incorporated under the General Statutes of the State of Connecticut.

The following entities are subsidiaries of the Corporation: Lawrence & Memorial Hospital ("L&M"), L&M Systems, Inc., VNA of Southeastern Connecticut, and L&M Healthcare. The VNA of Southeastern Connecticut Inc. is consolidated using financial statement balances at June 30, 2009 and 2008.

L&M Healthcare has an affiliation agreement effective January 31, 1999 (the "Agreement") with the Hospice of Southeastern Connecticut, Inc. (the "Hospice"). The Agreement gives L&M Healthcare a membership of the Hospice with one other not-for-profit healthcare organization. L&M Healthcare does not have an equity investment in the Hospice because the affiliation agreement does not require L&M Healthcare to provide capital to the Hospice and L&M Healthcare is not entitled to any of the net assets of the Hospice should the relationship terminate or the Hospice dissolve. The Corporation and its subsidiaries have never given capital to the Hospice and the Hospice has never made capital distributions to the Corporation or its subsidiaries.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

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

Temporarily and Permanently Restricted Net Assets

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

Lawrence & Memorial Corporation and Subsidiaries

Notes to Consolidated Financial Statements

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Donor Restricted Gifts

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

The Corporation adopted net asset classification guidance, which was effective for the Hospital as of October 1, 2007. The guidance was issued to provide clarification on net asset classifications on donor restricted endowment funds and improve the quality and consistency of financial reporting of endowments held by not-for-profit organizations subject to the guidance. Upon initial adoption, the Corporation recognized a reclassification in the amount of \$13,502,732, from unrestricted net assets to temporarily restricted net assets which reflects the portion of unrestricted net assets that had not been appropriated for spending as of October 1, 2007 and are therefore considered subject to time restrictions.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or law. Expirations of temporary restrictions on net assets because the donor-imposed purpose has been accomplished, the stipulated time period has elapsed, or the Corporation has appropriated gains for spending are reported as net assets released from restrictions.

From October 1, 2007 to September 30, 2008, the investment activity in the accompanying statements of operations, net unrealized gains/(losses) on investments was reclassified in the amount of \$3,176,000 to reflect the time restriction on true endowment activity.

Cash and Cash Equivalents

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

Investments

Investments in equity and debt securities are recorded at fair value in the balance sheet. Fair value is generally determined based on quoted market prices. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are included in the change in net assets. Under accounting principles generally accepted in the United States of America, an "other than temporary impairment" is recognized if the Corporation does not expect the fair value of a security to recover above cost or amortized cost. Once an "other than temporary impairment" charge has been recorded, a new cost basis is established.

The Corporation continues to review its securities for appropriate valuation on an ongoing basis. The Corporation determined that a portion of their investments was impaired as of September 30, 2008. The Statement of Operations reflects an other than temporary impairment of \$3,234,968 during fiscal year 2008. VNA recognized \$645,291 of other than temporary impairment on investments in 2009.

Lawrence & Memorial Corporation and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

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

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

Fair Value Measurements

Effective October 1, 2008, the Corporation adopted fair value guidance. The guidance defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value guidance provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information used to determine fair value.

Assets Held in Trust by Others

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

Assets Limited as to Use

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

Property, Plant and Equipment

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

Non-Operating Gains and Losses

Activities other than in connection with providing health care services are considered to be nonoperating.

Lawrence & Memorial Corporation and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

Excess of Revenues over Expenses

The statement of operations includes excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), and pension-related charges other than periodic pension costs and other postretirement benefits liabilities.

Fair Value of Financial Instruments

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

Benefit Plans

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

Medical Malpractice Self-Insurance

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

Income Taxes

The Corporation and its subsidiaries are not-for-profit organizations and are exempt from federal income taxes on related income under Section 501(c)(3) of the Internal Revenue Code, except for L&M Systems. L&M Systems provides for taxes based on current taxable income and the future tax consequences of temporary differences between financial and income tax reporting. Such amounts are not material to the consolidated financial statements.

Inventories

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

Impairment of Long-Lived Assets

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

Accrued Vacation and Sick Pay

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

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Subsequent Events

The Corporation has performed an evaluation of subsequent events through December 18, 2009, which is the date the financial statements were available to be issued.

2. Revenues from Services to Patients and Charity Care

The following summarizes net revenues from services to patients:

	2009	2008
Gross charges from services to patients	\$ 604,305,691	\$ 521,130,208
Less: charity care	<u>4,820,444</u>	<u>4,316,427</u>
Charges from services to patients, net of charity care	<u>599,485,247</u>	<u>516,813,781</u>
Deductions		
Allowances	306,380,434	239,892,364
State of Connecticut uncompensated care system	<u>(2,050,177)</u>	<u>(2,187,817)</u>
Total deductions	<u>304,330,257</u>	<u>237,704,547</u>
Net revenues from services to patients	<u>\$ 295,154,990</u>	<u>\$ 279,109,234</u>

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

Net patient service revenue is reported at the estimated net realizable amounts from patients, third party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Adjustments related to prior year settlements increased the Hospital's revenues by approximately \$385,000 and \$2,300,000 in 2009 and 2008, respectively.

During 2009 and 2008, approximately 31% and 32%, respectively, of net patient service revenue was received under the Medicare program, and 8% and 5%, respectively, under the state Medicaid program. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and reductions of funding levels could have an adverse impact on the Hospital.

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

Lawrence & Memorial Corporation and Subsidiaries
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3. Investments

Investments included in current assets consist of the following:

	2009	2008
Pooled endowment funds		
Cash and cash equivalents	\$ 247,120	\$ 253,556
Fixed income	1,174,041	1,093,178
Bonds	3,562,145	5,183,207
Mutual funds	855,154	999,404
Hedge funds	3,240,234	-
Marketable equities	11,410,013	14,009,795
Total pooled endowment funds	<u>20,488,707</u>	<u>21,539,140</u>
Investments held in trust by others		
Cash and cash equivalents	195,199	237,391
Bonds	1,811,440	1,917,632
Marketable equities	3,453,623	3,446,019
Other investments	151,306	182,840
Total investments held in trust by others	<u>5,611,568</u>	<u>5,783,882</u>
Other investments		
Cash and cash equivalents	13,344,183	12,670,139
Fixed income	1,172,180	1,103,518
Bonds	51,205,026	59,780,246
Mutual funds	853,798	1,008,857
Hedge funds	21,561,096	-
Marketable equities	53,077,369	64,254,653
Health Connecticut LLC	-	44,292
Connecticut Hospital Laboratory Network	11,894	-
Total other investments	<u>141,225,546</u>	<u>138,861,705</u>
	<u>\$ 167,325,821</u>	<u>\$ 166,184,727</u>

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

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

- Level 1 – Quoted prices in active markets for identical assets.

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

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

	2009			Total Fair Value	2008
	Level 1	Level 2	Level 3		Total Fair Value
Pooled endowment funds					
Cash and cash equivalents	\$ 247,120	\$ -	\$ -	\$ 247,120	\$ 253,556
Fixed income	130,375	1,043,666	-	1,174,041	1,093,178
Bonds	3,562,145	-	-	3,562,145	5,183,207
Mutual funds	855,154	-	-	855,154	999,404
Hedge funds	-	-	3,240,234	3,240,234	-
Marketable equities	11,410,013	-	-	11,410,013	14,009,795
Total pooled endowment funds	<u>16,204,807</u>	<u>1,043,666</u>	<u>3,240,234</u>	<u>20,488,707</u>	<u>21,539,140</u>
Held in trust by others					
Cash and cash equivalents	-	-	195,199	195,199	237,391
Bonds	-	-	1,811,440	1,811,440	1,917,632
Other assets	-	-	151,306	151,306	182,840
Marketable equities	-	-	3,453,623	3,453,623	3,446,019
Total held in trust by others	<u>-</u>	<u>-</u>	<u>5,611,568</u>	<u>5,611,568</u>	<u>5,783,882</u>
Other investments					
Cash and cash equivalents	13,344,183	-	-	13,344,183	12,670,139
Fixed income	130,166	1,042,014	-	1,172,180	1,103,518
Bonds	51,205,026	-	-	51,205,026	59,780,246
Mutual funds	853,798	-	-	853,798	1,008,857
Hedge funds	-	-	21,561,096	21,561,096	-
Marketable equities	53,077,369	-	-	53,077,369	64,254,653
Health Connecticut LLC	-	-	-	-	44,292
Connecticut Hospital Laboratory Network	-	-	11,894	11,894	-
Total other investments	<u>118,610,542</u>	<u>1,042,014</u>	<u>21,572,990</u>	<u>141,225,546</u>	<u>138,861,705</u>
	<u>\$ 134,815,349</u>	<u>\$ 2,085,680</u>	<u>\$ 30,424,792</u>	<u>\$ 167,325,821</u>	<u>\$ 166,184,727</u>

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

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

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

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

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

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

	Beginning October 1, 2008	Investment Income	Realized Losses	Unrealized Gains/ (Losses)	Investment Fees	Net Transfers	Ending September 30, 2009
Investment pool							
Hedge funds	\$ -	\$ 131,180	\$ (70,175)	\$ 2,893,941	\$ (31,255)	\$ 21,889,534	\$ 24,813,224
Funds held in trust	5,783,882	-	-	(172,314)	-	-	5,611,568
Total	<u>\$ 5,783,882</u>	<u>\$ 131,180</u>	<u>\$ (70,175)</u>	<u>\$ 2,721,627</u>	<u>\$ (31,255)</u>	<u>\$ 21,889,534</u>	<u>\$ 30,424,792</u>

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

	2009	2008
Investment income	\$ 510,376	\$ 558,150
Realized and unrealized losses	(659,407)	(4,402,156)
Management fees and other costs	(13,974)	(33,727)
Total return on pooled endowment investments	<u>\$ (163,005)</u>	<u>\$ (3,877,733)</u>

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4. Endowments

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

The Corporation understands net asset classification guidance to require that donor restricted endowment gifts be maintained in perpetuity. Consistent with net asset classification guidance, the Corporation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure. The Corporation considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund
- The purposes of the Corporation and donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Corporation
- The investment policies of the Corporation

The Corporation had the following endowment activities during the years ended September 30, 2009 and 2008 delineated by net asset class and donor-restricted funds:

Endowment net asset composition by type of fund as of September 30:

	2009			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor restricted endowment funds	\$ -	\$ 14,945,419	\$ 2,866,683	\$ 17,812,102
Board designated endowment funds	4,930,901	-	-	4,930,901
	<u>\$ 4,930,901</u>	<u>\$ 14,945,419</u>	<u>\$ 2,866,683</u>	<u>\$ 22,743,003</u>

	2008			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor restricted endowment funds	\$ -	\$ 15,366,143	\$ 2,866,683	\$ 18,232,826
Board designated endowment funds	5,195,881	-	-	5,195,881
	<u>\$ 5,195,881</u>	<u>\$ 15,366,143</u>	<u>\$ 2,866,683</u>	<u>\$ 23,428,707</u>

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Changes in endowment net assets for the year ended September 30:

	2009			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets, beginning of year	\$ 5,195,881	\$ 15,366,143	\$ 2,866,683	\$ 23,428,707
Investment return				
Investment income	61,050	(96,771)	-	(35,721)
Net realized and unrealized loss	(383,527)	(579,243)	-	(962,770)
Contributions	57,497	455,412	-	512,909
Total investment return	(264,980)	(220,602)	-	(485,582)
Income distribution	-	(200,122)	-	(200,122)
Endowment net assets, end of year	<u>\$ 4,930,901</u>	<u>\$ 14,945,419</u>	<u>\$ 2,866,683</u>	<u>\$ 22,743,003</u>

	2008			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets, beginning of year	\$ 18,806,152	\$ 3,413,410	\$ 2,866,683	\$ 25,086,245
Cumulative effect of change in accounting principle (Note 1)	(13,502,732)	13,502,732	-	-
Endowment net assets, beginning of year, as reclassified	5,303,420	16,916,142	2,866,683	25,086,245
Investment return				
Investment income	182,125	(1,087,827)	-	(905,702)
Net realized and unrealized loss	(343,790)	(532,241)	-	(876,031)
Contributions	54,126	156,290	-	210,416
Total investment return	(107,539)	(1,463,778)	-	(1,571,317)
Income distribution	-	(86,221)	-	(86,221)
Endowment net assets, end of year	<u>\$ 5,195,881</u>	<u>\$ 15,366,143</u>	<u>\$ 2,866,683</u>	<u>\$ 23,428,707</u>

Endowment funds classified as permanently and temporarily restricted net assets:

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

	2009	2008
Permanently restricted net assets		
Corpus of permanently restricted contributions for purchase of equipment and healthcare services	<u>\$ 2,866,683</u>	<u>\$ 2,866,683</u>
Total endowment funds classified as permanently restricted net assets	<u>\$ 2,866,683</u>	<u>\$ 2,866,683</u>
Temporarily restricted net assets		
Unspent income and appreciation on permanently restricted endowments for purchase of equipment and healthcare services	<u>\$ 11,769,419</u>	<u>\$ 12,190,143</u>
Total endowment funds classified as Temporarily restricted net assets	<u>\$ 11,769,419</u>	<u>\$ 12,190,143</u>

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Endowment Funds with Deficits

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist they are classified as a reduction of unrestricted net assets. The Corporation analyzed the endowments and notes there are no deficits as of September 30, 2009 and 2008.

Endowment Investment Return Objectives and Risk Parameters

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

Strategies Employed for Achieving Endowment Investment Objectives

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

Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives

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

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

5. Temporary and Permanently Restricted Net Assets

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

	2009	2008 (as reclassified)
Funds held in trust by others	\$ 2,924,192	\$ 2,984,519
Contributions receivable	1,327,113	96,961
Free beds and plant replacement and expansion	11,769,419	12,190,143
Specific purpose reserves	1,738,231	2,866,406
	<u>\$ 17,758,955</u>	<u>\$ 18,138,029</u>

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Permanently restricted net assets at September 30, 2009 and 2008 are restricted to:

	2009	2008
Funds held in trust by others	\$ 2,705,430	\$ 2,768,541
Donor restricted endowment funds	2,866,683	2,866,683
	<u>\$ 5,572,113</u>	<u>\$ 5,635,224</u>

6. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	2009	2008
Land and land improvements	\$ 5,989,744	\$ 5,989,744
Buildings	109,065,547	102,714,391
Equipment	<u>172,887,816</u>	<u>157,096,129</u>
	287,943,107	265,800,264
Less: Accumulated depreciation	<u>(183,553,654)</u>	<u>(168,487,889)</u>
	104,389,453	97,312,375
Construction in progress (estimated cost to complete at September 30, 2009 is \$6,280,990)	<u>5,352,416</u>	<u>7,377,180</u>
	<u>\$ 109,741,869</u>	<u>\$ 104,689,555</u>

7. Long-Term Debt

	2009	2008
CHEFA Series D revenue bonds		
5.0% Term bonds, due 2009 to 2013	\$ 11,390,000	\$ 13,905,000
5.0% Term bonds, due 2014 to 2022	33,870,000	33,870,000
CHEFA Series E revenue bonds		
Variable rate bonds, due 2023-2034	22,990,000	22,990,000
VNA mortgage note		
Variable rate, due 2001 to 2011	302,734	333,833
VNA Interest rate swap agreement	<u>60,259</u>	<u>51,172</u>
Total long-term debt outstanding	68,612,993	71,150,005
Less amounts classified as current	<u>2,674,572</u>	<u>2,548,684</u>
Total long-term portion of long-term debt	<u>\$ 65,938,421</u>	<u>\$ 68,601,321</u>

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On June 24, 2004 CHEFA issued \$22,990,000 of Series E Bonds (the "Series E Bonds") on behalf of the Hospital and the Corporation (collectively referred to as the "Obligated Group" under the Series E Bond agreements). The Series E Bonds are structured with a term bond due July 1, 2034, with annual sinking fund payments due each July 1st commencing July 1, 2003. Interest on the Series E Bonds accrues at the weekly rate and is payable on the first business day of each month commencing July 1, 2004.

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

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

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

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

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

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

The fair value of the Series E Bonds, using discounted cash flow analyses, approximates carrying value. The fair value of the Series D Bonds is approximately \$45.4 and \$43.5 million at September 30, 2009 and 2008, respectively.

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The VNA has a \$1.0 million ten year variable rate mortgage note bearing interest at one percent above the LIBOR rate (1.60% and 3.42% at June 30, 2009 and 2008, respectively). The VNA maintains an interest rate swap agreement for this debt at a rate of 8.35%. The loan is based on a 20 year amortization period. The VNA's interest rate swap agreement has a negative fair value of \$60,259 and \$51,172 as of June 30, 2009 and 2008, respectively, which has been reflected as a long-term liability included with long-term debt. The balance of the loan is \$302,734 and \$333,833 at June 30, 2009 and 2008, respectively. The note is collateralized by a first mortgage on the property, buildings and building improvements located in Waterford, Connecticut.

Principal repayments are as follows:

Year	Annual Principal Repayment
2010	\$ 2,674,572
2011	2,814,915
2012	3,203,506
2013	3,060,000
2014 and thereafter	<u>56,860,000</u>
	<u>\$ 68,612,993</u>

Cash interest payments of \$2,536,615 and \$3,393,141 were made in fiscal year 2009 and 2008, respectively. No interest was capitalized during 2009 and 2008.

8. Pension and Other Postretirement Benefits

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

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

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The following table sets forth the Hospital's plans' funded status and amounts recognized in the statement of financial position for fiscal year 2009 and 2008 as of September 30 (measurement date of September 30):

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 92,839,307	\$ 102,691,106	\$ 1,305,378	\$ 1,594,902
Service cost	1,456,782	2,088,945	-	-
Interest cost	6,784,733	6,328,208	85,675	87,570
Employee contributions	184,560	196,482	-	-
Benefits paid	(4,825,526)	(4,342,286)	(141,246)	(149,919)
Actuarial gain/(loss)	20,890,290	(14,123,148)	40,771	(227,175)
Benefit obligation at end of year	<u>\$ 117,330,146</u>	<u>\$ 92,839,307</u>	<u>\$ 1,290,578</u>	<u>\$ 1,305,378</u>
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 74,130,658	\$ 88,881,587	\$ -	\$ -
Actual return on plan assets	4,690,576	(12,105,125)	-	-
Employee contributions	184,560	196,482	-	-
Employer contributions	2,164,304	1,500,000	141,246	149,919
Benefits paid	(4,825,526)	(4,342,286)	(141,246)	(149,919)
Fair value of plan assets at end of year	<u>\$ 76,344,572</u>	<u>\$ 74,130,658</u>	<u>\$ -</u>	<u>\$ -</u>
Funded status of the plan	(40,985,574)	(18,708,649)	(1,290,578)	(1,305,378)
Unrecognized net loss (gain) from past experience different from that assumed and effects of changes in assumptions	29,882,430	7,503,368	(639,914)	(763,507)
Unrecognized prior service cost	<u>721,505</u>	<u>846,461</u>	<u>-</u>	<u>-</u>
Accrued benefit costs recognized in the statement of operation	<u>\$ (10,381,639)</u>	<u>\$ 8,349,829</u>	<u>\$ (1,930,492)</u>	<u>\$ (763,885)</u>
Components of net periodic benefit costs				
Service cost	\$ 1,456,782	\$ 2,088,945	\$ -	\$ -
Interest cost	6,784,733	6,328,208	85,675	87,570
Expected return on plan assets	(6,179,348)	(7,449,086)	-	-
Gain	-	-	(82,822)	(63,014)
Net amortization and deferral	<u>124,956</u>	<u>(336,668)</u>	<u>-</u>	<u>163,000</u>
Benefit cost	<u>\$ 2,187,123</u>	<u>\$ 631,399</u>	<u>\$ 2,853</u>	<u>\$ 187,556</u>

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

	2009	2008
Discount rate	7.50%	6.29%
Average rate of compensation increases	4.25%	4.25%
Expected return on assets	8.50%	8.50%

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

	2009	2008
Discount rate	5.80%	7.50%
Average rate of compensation increases	4.25%	4.25%

The Plan's asset allocations as of September 30, 2009 and 2008 are as follows:

	2009	2008
Asset Category		
Equity securities	50%	47%
Debt securities	33%	52%
Other	17%	1%
Total	<u>100%</u>	<u>100%</u>

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

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

Fiscal Years Beginning October 1	Expected Benefits
2009	\$ 5,461,268
2010	5,732,572
2011	6,270,622
2012	6,573,598
2013	6,987,610
Expected Aggregate for 5 fiscal years beginning 2014	40,008,411

Annual contributions are determined by the Hospital based upon calculations prepared by the plan's actuary. Expected contributions to the Pension and Retiree Health Plan for 2010 are approximately:

Pension	\$ 2,000,000
Retiree Health	131,755

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The weighted-average annual assumed rate of increase in the per capita cost of covered benefits (i.e., health care cost trend rate) for participants is assumed to be 9% in 2010 reducing to 5.0% by the year 2016 and remaining at that level thereafter. This health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, a one percentage point increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation and service cost plus interest cost by approximately \$98,000 and \$87,000, respectively, at September 30, 2009 and 2008. A one percentage point decrease in the assumed health care cost trend rate would decrease the accumulated postretirement benefit obligation and service cost plus interest cost by approximately \$76,000 and \$69,000, respectively, at September 30, 2009 and 2008.

The Hospital's 401(k) plan covers eligible employees who elected to participate in the plan. Eligible employees may contribute a percentage of their salary to the plan. The Hospital matches 100% of the first 4% of gross pay deferred by employees for those employees who do not participate in the defined benefit plan. Plan contributions charged to operations were approximately \$2,131,755 and \$2,253,036 for 2009 and 2008, respectively.

The VNA has a defined contribution pension plan which covers substantially all of its employees who have met specified age and length of service requirements. Contributions to the plan are based on 5% of eligible salaries and totaled approximately \$411,000 and \$459,000 for the years ended June 30, 2009 and 2008, respectively.

9. Medical Malpractice Self-Insurance

There have been malpractice claims that fall within the Hospital's self-insured program which have been asserted against the Hospital. In addition, there are known incidents that have occurred through September 30, 2009 that may result in the assertion of claims. The Hospital has engaged independent actuaries to estimate the ultimate cost of the settlement of such claims. Accrued malpractice losses have been discounted at 5.0% for 2009 and 2008. The Hospital maintains a trust to fund these liabilities on a long-term basis.

10. Functional Expenses

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

	2009	2008
Health care services	\$ 239,207,882	\$ 232,055,202
General and administrative	67,468,890	61,685,560
	<u>\$ 306,676,772</u>	<u>\$ 293,740,762</u>

11. Contingency

The Corporation and its subsidiaries are parties to various lawsuits incidental to their business. Management believes that the lawsuits will not have a material adverse effect on their financial position, results of operations, changes in net assets or cash flows.

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Consolidating Balance Sheet
September 30, 2009

	Lawrence & Memorial Hospital	Lawrence & Memorial Corporation	Eliminating Entries	Obligated Group	L&M Systems, Inc.	VNA of Southeastern Connecticut, Inc.	Eliminating Entries	Consolidated
Assets								
Current assets								
Cash and cash equivalents	\$ 22,869,913	\$ 5,214,133	\$ -	\$ 28,084,046	\$ 506,860	\$ 1,459,043	\$ -	\$ 30,049,949
Investments	99,233,961	38,239,335	-	137,473,296	-	3,752,250	-	141,225,546
Accounts receivable	28,570,370	-	-	28,570,370	-	1,391,265	-	29,961,635
Other receivables	5,995,236	-	-	5,995,236	548,174	-	-	6,543,410
Inventories	3,506,113	-	-	3,506,113	-	-	-	3,506,113
Due from affiliates	2,903,156	541,500	(2,903,156)	541,500	-	-	(517,000)	24,500
Prepaid expenses and other current assets	2,312,579	-	-	2,312,579	-	225,422	-	2,538,001
Debt service fund	1,295,094	-	-	1,295,094	-	-	-	1,295,094
Total current assets	166,686,422	43,994,968	(2,903,156)	207,778,234	1,055,034	6,827,980	(517,000)	215,144,248
Assets limited as to use								
Cash	177,710	-	-	177,710	-	-	-	177,710
Construction fund	6,170	-	-	6,170	-	-	-	6,170
Investments held in trust	12,678,851	-	-	12,678,851	-	-	-	12,678,851
Endowment investments	14,150,668	2,633,876	-	16,784,544	-	3,704,163	-	20,488,707
Investment in subsidiaries	-	17,008,597	-	17,008,597	-	-	(17,008,597)	-
Funds held in Trust by others	5,611,568	-	-	5,611,568	-	-	-	5,611,568
Contributions receivable	48,469	1,278,644	-	1,327,113	-	-	-	1,327,113
Funds held in escrow by agreement with Statement of Connecticut Health and Educational Facilities Authority and trustees	7,159,610	-	-	7,159,610	-	-	-	7,159,610
Total assets limited as to use	39,833,046	20,921,117	-	60,754,163	-	3,704,163	(17,008,597)	47,449,729
Other assets								
Deferred financing costs and other assets, net	2,779,069	-	-	2,779,069	-	-	-	2,779,069
Property, plant and equipment								
Land improvements	5,128,782	530,687	-	5,659,469	-	330,275	-	5,989,744
Buildings/leasehold improvements	105,218,566	148,821	-	105,367,387	1,330,730	2,367,430	-	109,065,547
Equipment/furniture	170,465,895	21,774	-	170,487,669	628,079	1,772,068	-	172,887,816
Accumulated depreciation	(180,112,431)	(59,332)	-	(180,171,763)	(1,195,609)	(2,186,282)	-	(183,553,654)
Construction in progress	5,352,416	-	-	5,352,416	-	-	-	5,352,416
Property, plant and equipment, net	106,053,228	641,950	-	106,695,178	763,200	2,283,491	-	109,741,869
	\$ 315,351,765	\$ 65,558,035	\$ (2,903,156)	\$ 378,006,644	\$ 1,818,234	\$ 12,815,634	\$ (17,525,597)	\$ 375,114,915

Lawrence & Memorial Corporation and Subsidiaries
Consolidating Balance Sheet
September 30, 2009

	Lawrence & Memorial Hospital	Lawrence & Memorial Corporation	Eliminating Entries	Obligated Group	L&M Systems, Inc.	VNA of Southeastern Connecticut, Inc.	Eliminating Entries	Consolidated
Liabilities and Net Assets								
Current liabilities								
Accounts payable	\$ 13,893,859	\$ 97,828	\$ -	\$ 13,991,687	\$ 173,294	\$ 1,312,062	\$ -	\$ 15,477,043
Accrued vacation and sick pay	10,641,451	-	-	10,641,451	-	-	-	10,641,451
Salaries, wages, payroll taxes and amounts withheld from employees	4,184,333	-	-	4,184,333	-	-	-	4,184,333
Due to affiliates	1,682,710	1,939,203	(2,903,156)	718,757	517,000	-	(517,000)	718,757
Due to third party payors	9,089,438	-	-	9,089,438	-	133,298	-	9,222,736
Other current liabilities	-	-	-	-	5,969	358,084	-	364,053
Current portion of long-term debt	2,640,000	-	-	2,640,000	-	34,572	-	2,674,572
Total current liabilities	42,131,791	2,037,031	(2,903,156)	41,265,666	696,263	1,838,016	(517,000)	43,282,945
Accrued pension and other postretirement benefits	43,029,547	-	-	43,029,547	5,737	-	-	43,035,284
Other liabilities	12,202,253	-	-	12,202,253	-	-	-	12,202,253
Long-term debt less current portion	65,610,000	-	-	65,610,000	-	328,421	-	65,938,421
Total liabilities	162,973,591	2,037,031	(2,903,156)	162,107,466	702,000	2,166,437	(517,000)	164,458,903
Net assets								
Unrestricted	129,621,224	62,973,886	-	192,595,110	1,116,234	10,622,197	(17,008,597)	187,324,944
Temporarily restricted	17,211,837	547,118	-	17,758,955	-	-	-	17,758,955
Permanently restricted	5,545,113	-	-	5,545,113	-	27,000	-	5,572,113
Total net assets	152,378,174	63,521,004	-	215,899,178	1,116,234	10,649,197	(17,008,597)	210,656,012
	\$ 315,351,765	\$ 65,558,035	\$ (2,903,156)	\$ 378,006,644	\$ 1,818,234	\$ 12,815,634	\$ (17,525,597)	\$ 375,114,915

Lawrence & Memorial Corporation and Subsidiaries
Consolidating Balance Sheet
September 30, 2008

	Lawrence & Memorial Hospital	Lawrence & Memorial Corporation	Eliminating Entries	Obligated Group	L&M Systems, Inc.	VNA of Southeastern Connecticut, Inc.	Eliminating Entries	Consolidated
Assets								
Current assets								
Cash and cash equivalents	\$ 18,257,347	\$ 6,204,928	\$ -	\$ 24,462,275	\$ 22,278	\$ 698,153	\$ -	\$ 25,182,706
Investments	98,453,853	36,401,166	-	134,855,019	-	4,006,686	-	138,861,705
Accounts receivable	34,818,517	-	-	34,818,517	-	1,767,816	-	36,586,333
Other receivables	3,934,572	81,622	-	4,016,194	672,223	-	-	4,688,417
Inventories	3,357,049	-	-	3,357,049	-	-	-	3,357,049
Due from affiliates	1,188,700	24,500	(1,188,699)	24,501	-	-	-	24,501
Prepaid expenses and other current assets	1,906,505	-	-	1,906,505	-	119,680	-	2,026,185
Debt service fund	1,294,037	-	-	1,294,037	-	-	-	1,294,037
Total current assets	163,210,580	42,712,216	(1,188,699)	204,734,097	694,501	6,592,335	-	212,020,933
Assets limited as to use								
Cash	210,229	-	-	210,229	-	-	-	210,229
Construction fund	6,127	-	-	6,127	-	-	-	6,127
Investments held in trust	12,999,368	-	-	12,999,368	-	-	-	12,999,368
Endowment investments	14,857,509	2,712,488	-	17,569,997	-	3,969,143	-	21,539,140
Investment in subsidiaries	-	14,021,532	-	14,021,532	-	-	(14,021,532)	-
Funds held in Trust by others	5,783,882	-	-	5,783,882	-	-	-	5,783,882
Contributions receivable	96,961	584,291	-	681,252	-	-	-	681,252
Funds held in escrow by agreement with Statement of Connecticut Health and Educational Facilities Authority and trustees	7,341,007	-	-	7,341,007	-	-	-	7,341,007
Total assets limited as to use	41,295,083	17,318,311	-	58,613,394	-	3,969,143	(14,021,532)	48,561,005
Other assets								
Deferred financing costs	2,989,857	-	-	2,989,857	-	-	-	2,989,857
Property, plant and equipment								
Land and land improvement	5,128,782	530,687	-	5,659,469	-	330,275	-	5,989,744
Buildings/leasehold improvements	99,620,031	148,821	-	99,768,852	1,330,730	2,367,430	-	103,467,012
Equipment/furniture	154,156,033	21,773	-	154,177,806	578,108	1,587,594	-	156,343,508
Accumulated depreciation	(165,554,431)	(51,175)	-	(165,605,606)	(946,374)	(1,935,909)	-	(168,487,889)
Construction in progress	7,377,180	-	-	7,377,180	-	-	-	7,377,180
Property, plant and equipment, net	100,727,595	650,106	-	101,377,701	962,464	2,349,390	-	104,689,555
	\$ 308,223,115	\$ 60,680,633	\$ (1,188,699)	\$ 367,715,049	\$ 1,656,965	\$ 12,910,868	\$ (14,021,532)	\$ 368,261,350

Lawrence & Memorial Corporation and Subsidiaries
Consolidating Balance Sheet
September 30, 2008, as reclassified

	Lawrence & Memorial Hospital	Lawrence & Memorial Corporation	Eliminating Entries	Obligated Group	L&M Systems, Inc.	VNA of Southeastern Connecticut, Inc.	Eliminating Entries	Consolidated
Liabilities and Net Assets								
Current liabilities								
Accounts payable	\$ 17,863,591	\$ -	\$ -	\$ 17,863,591	\$ 265,920	\$ 1,238,525	\$ -	\$ 19,368,036
Accrued vacation and sick pay	10,165,897	-	-	10,165,897	-	-	-	10,165,897
Salaries, wages, payroll taxes and amounts withheld from employees	3,700,920	-	-	3,700,920	-	-	-	3,700,920
Due to affiliates	573,153	1,038,457	(1,188,699)	422,911	-	-	-	422,911
Due to third party payors	7,993,615	-	-	7,993,615	-	133,298	-	8,126,913
Other current liabilities	-	-	-	-	5,969	392,407	-	398,376
Current portions of long-term debt	2,515,000	-	-	2,515,000	-	33,684	-	2,548,684
Total current liabilities	42,812,176	1,038,457	(1,188,699)	42,661,934	271,889	1,797,914	-	44,731,737
Accrued pension and other postretirement benefits	20,629,212	-	-	20,629,212	2,068	-	-	20,631,280
Other liabilities	11,764,379	-	-	11,764,379	-	-	-	11,764,379
Long-term debt less current portion	68,250,000	-	-	68,250,000	-	351,321	-	68,601,321
Total liabilities	143,455,767	1,038,457	(1,188,699)	143,305,525	273,957	2,149,235	-	145,728,717
Net assets								
Unrestricted, as reclassified	141,290,161	59,373,110	-	200,663,271	1,383,008	10,734,633	(14,021,532)	198,759,380
Temporarily restricted, as reclassified	17,868,963	269,066	-	18,138,029	-	-	-	18,138,029
Permanently restricted	5,608,224	-	-	5,608,224	-	27,000	-	5,635,224
Total net assets	164,767,348	59,642,176	-	224,409,524	1,383,008	10,761,633	(14,021,532)	222,532,633
	<u>\$ 308,223,115</u>	<u>\$ 60,680,633</u>	<u>\$ (1,188,699)</u>	<u>\$ 367,715,049</u>	<u>\$ 1,656,965</u>	<u>\$ 12,910,868</u>	<u>\$ (14,021,532)</u>	<u>\$ 368,261,350</u>

Lawrence & Memorial Corporation and Subsidiaries
Consolidating Statement of Operations
Year Ended September 30, 2009

	Lawrence & Memorial Hospital	Lawrence & Memorial Corporation	Eliminating Entries	Obligated Group	L&M Systems, Inc.	VNA of Southeastern Connecticut, Inc.	Eliminating Entries	Consolidated
Net revenues from services to patients	\$ 283,933,518	\$ -	\$ -	\$ 283,933,518	\$ -	\$ 11,221,472	\$ -	\$ 295,154,990
Other operating revenues	8,924,533	2,179,900	-	11,104,433	3,324,953	3,150,482	-	17,579,868
Net assets released from restriction	460,320	-	-	460,320	-	-	-	460,320
	<u>293,318,371</u>	<u>2,179,900</u>	<u>-</u>	<u>295,498,271</u>	<u>3,324,953</u>	<u>14,371,954</u>	<u>-</u>	<u>313,195,178</u>
Operating expenses								
Salaries and wages	135,533,992	-	-	135,533,992	1,839,702	9,457,006	-	146,830,700
Employee benefits	35,728,800	-	-	35,728,800	548,276	2,212,869	-	38,489,945
Supplies	31,017,186	14	-	31,017,200	229,317	999,206	-	32,245,723
Purchased services	21,328,169	1,215	-	21,329,384	506,800	171,109	-	22,007,293
Bad debts	15,807,846	-	-	15,807,846	1,785,718	64,225	-	17,657,789
Other	29,002,754	323,970	-	29,326,724	700,765	340,808	-	30,368,297
Interest	2,570,991	-	-	2,570,991	66,572	35,816	-	2,673,379
Depreciation and amortization	15,891,356	8,156	-	15,899,512	253,761	250,373	-	16,403,646
	<u>286,881,094</u>	<u>333,355</u>	<u>-</u>	<u>287,214,449</u>	<u>5,930,911</u>	<u>13,531,412</u>	<u>-</u>	<u>306,676,772</u>
Income from operations	6,437,277	1,846,545	-	8,283,822	(2,605,958)	840,542	-	6,518,406
Nonoperating gains								
Unrestricted investment income	266,039	-	-	266,039	-	-	-	266,039
(Loss)/income on investments	(691,170)	47,448	-	(643,722)	(647,881)	308,316	-	(983,287)
Realized losses on investments deemed other than temporarily impaired	-	-	-	-	-	(645,287)	-	(645,287)
	<u>(425,131)</u>	<u>47,448</u>	<u>-</u>	<u>(377,683)</u>	<u>(647,881)</u>	<u>(336,971)</u>	<u>-</u>	<u>(1,362,535)</u>
Excess of revenues over expenses	6,012,146	1,893,993	-	7,906,139	(3,253,839)	503,571	-	5,155,871
Net unrealized gains/(losses) on investments	4,304,504	1,529,423	-	5,833,927	-	(616,003)	-	5,217,924
Net assets released from restrictions used for purchases of property and equipment	208,519	177,360	-	385,879	-	-	-	385,879
Forgiveness of debt	-	-	-	-	2,987,065	-	(2,987,065)	-
Pension - related changes other than periodic pension costs	(22,254,106)	-	-	(22,254,106)	-	-	-	(22,254,106)
Donated equipment	60,000	-	-	60,000	-	-	-	60,000
Decrease in unrestricted net assets	<u>\$ (11,668,937)</u>	<u>\$ 3,600,776</u>	<u>\$ -</u>	<u>\$ (8,068,161)</u>	<u>\$ (266,774)</u>	<u>\$ (112,432)</u>	<u>\$ (2,987,065)</u>	<u>\$ (11,434,432)</u>

Lawrence & Memorial Corporation and Subsidiaries
Consolidating Statement of Operations
Year Ended September 30, 2008

	Lawrence & Memorial Hospital	Lawrence & Memorial Corporation	Eliminating Entries	Obligated Group	L&M Systems, Inc.	VNA of Southeastern Connecticut, Inc.	Eliminating Entries	Consolidated
Net revenues from services to patients	\$ 268,658,867	\$ -	\$ -	\$ 268,658,867	\$ -	\$ 10,450,367	\$ -	\$ 279,109,234
Other operating revenues	8,913,680	5,468,712	-	14,382,392	2,379,599	3,060,023	-	19,822,014
Net assets released from restriction	422,147	-	-	422,147	-	-	-	422,147
	<u>277,994,694</u>	<u>5,468,712</u>	<u>-</u>	<u>283,463,406</u>	<u>2,379,599</u>	<u>13,510,390</u>	<u>-</u>	<u>299,353,395</u>
Operating expenses								
Salaries and wages	127,169,386	63,620	-	127,233,006	1,611,972	10,136,264	-	138,981,242
Employee benefits	32,787,266	-	-	32,787,266	452,753	2,555,034	-	35,795,053
Supplies	29,399,963	10,333	-	29,410,296	254,218	452,813	-	30,117,327
Purchased services	21,706,666	13,839	-	21,720,505	317,781	64,683	-	22,102,969
Bad debts	17,211,050	-	-	17,211,050	867,825	52,500	-	18,131,375
Other	27,468,045	1,345,600	-	28,813,645	596,388	1,055,051	-	30,465,084
Interest	3,359,213	-	-	3,359,213	87,972	33,416	-	3,480,601
Depreciation and amortization	14,187,153	8,633	-	14,195,786	221,356	249,966	-	14,667,108
	<u>273,288,742</u>	<u>1,442,025</u>	<u>-</u>	<u>274,730,767</u>	<u>4,410,265</u>	<u>14,599,727</u>	<u>-</u>	<u>293,740,759</u>
Income from operations	4,705,952	4,026,687	-	8,732,639	(2,030,666)	(1,089,337)	-	5,612,636
Nonoperating gains								
Unrestricted investment income	322,958	-	-	322,958	-	-	-	322,958
Income from investments	4,103,651	-	-	4,103,651	-	585,930	-	4,689,581
Realized losses on investments deemed other than temporarily impaired	(2,751,358)	(483,610)	-	(3,234,968)	-	-	-	(3,234,968)
	<u>1,675,251</u>	<u>(483,610)</u>	<u>-</u>	<u>1,191,641</u>	<u>-</u>	<u>585,930</u>	<u>-</u>	<u>1,777,571</u>
Excess of revenues over expenses	6,381,203	3,543,077	-	9,924,280	(2,030,666)	(503,407)	-	7,390,207
Transfers among affiliated entities	9,127	(9,127)	-	-	-	-	-	-
Net unrealized gains (losses) on investments	(16,993,099)	(4,793,079)	-	(21,786,178)	-	(827,301)	-	(22,613,479)
Net assets released from restrictions used for purchase of property, plant and equipment	203,651	1,161,752	-	1,365,403	-	-	-	1,365,403
Forgiveness of debt	-	-	-	-	2,524,658	-	(2,524,658)	-
Pension - related changes other than periodic pension costs	(5,290,651)	-	-	(5,290,651)	-	-	-	(5,290,651)
Donated equipment	1,214,894	-	-	1,214,894	-	-	-	1,214,894
Decrease in unrestricted net assets, as reclassified	<u>\$ (14,474,875)</u>	<u>\$ (97,377)</u>	<u>\$ -</u>	<u>\$ (14,572,252)</u>	<u>\$ 493,992</u>	<u>\$ (1,330,708)</u>	<u>\$ (2,524,658)</u>	<u>\$ (17,933,626)</u>