



CONSOLIDATED FINANCIAL STATEMENTS  
AND OTHER FINANCIAL INFORMATION

Sharon Hospital Holding Company, Inc. and Subsidiaries  
Years Ended September 30, 2010 and 2009  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Sharon Hospital Holding Company, Inc. and Subsidiaries

Consolidated Financial Statements  
and Other Financial Information

Years Ended September 30, 2010 and 2009

**Contents**

Report of Independent Auditors.....	1
Consolidated Financial Statements	
Consolidated Balance Sheets .....	2
Consolidated Statements of Income.....	4
Consolidated Statements of Stockholder's Equity.....	5
Consolidated Statements of Cash Flows.....	6
Notes to Consolidated Financial Statements.....	7
Other Financial Information	
Report of Independent Auditors on Other Financial Information .....	22
Consolidating Balance Sheet .....	23
Consolidating Statement of Operations .....	25

## Report of Independent Auditors

The Board of Directors  
Sharon Hospital Holding Company, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Sharon Hospital Holding Company, Inc. and Subsidiaries as of September 30, 2010 and 2009, and the related statements of income, stockholder's equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sharon Hospital Holding Company, Inc. and Subsidiaries at September 30, 2010 and 2009, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

*Ernst & Young LLP*

January 12, 2011

Sharon Hospital Holding Company, Inc.  
and Subsidiaries

Consolidated Balance Sheets

	September 30	
	2010	2009
<b>Assets</b>		
Current assets:		
Patient accounts receivable, net of allowance for doubtful accounts of \$4,034,864 in 2010 and \$4,044,869 in 2009	\$ 6,242,425	\$ 6,542,170
Inventories	1,162,381	1,140,534
Prepaid expenses and other receivables	598,277	1,526,863
Deferred income taxes	1,640,784	1,627,405
Total current assets	9,643,867	10,836,972
Property and equipment:		
Land and land improvements	1,797,359	1,797,359
Buildings	39,391,598	39,340,742
Equipment	17,501,434	16,149,430
Construction in progress	242,040	235,793
	58,932,431	57,523,324
Less accumulated depreciation	(19,807,940)	(16,518,636)
	39,124,491	41,004,688
Amounts due from Parent	8,029,726	5,228,965
Other	502,089	502,632
Total assets	\$ 57,300,173	\$ 57,573,257

Sharon Hospital Holding Company, Inc.  
and Subsidiaries

Consolidated Balance Sheets (continued)

	September 30	
	2010	2009
<b>Liabilities and stockholder's equity</b>		
Current liabilities:		
Accounts payable and other liabilities	\$ 1,370,735	\$ 1,983,168
Other accrued expenses	3,596,931	3,690,101
Due to third-party payors	322,546	435,106
Current portion of capital lease obligations	547,476	606,509
Current portion of long-term debt	350,000	350,000
Total current liabilities	6,187,688	7,064,884
Accrued post-retirement benefits	1,502,000	1,407,000
Deferred income taxes	683,645	762,982
Capital lease obligations, less current portion	470,384	1,001,842
Long-term debt, less current portion	33,687,500	34,037,500
Other	250,000	250,000
Stockholder's equity:		
Common stock; no par; 1,000 shares authorized; 1,000 shares issued and outstanding	1,000	1,000
Other comprehensive loss	(456,977)	(353,878)
Retained earnings	14,974,933	13,401,927
Total stockholder's equity	14,518,956	13,049,049
Total liabilities and stockholder's equity	\$ 57,300,173	\$ 57,573,257

*See accompanying notes.*

Sharon Hospital Holding Company, Inc.  
and Subsidiaries

Consolidated Statements of Income

	Year Ended September 30	
	2010	2009
Net revenues:		
Net patient revenue	\$ 54,034,467	\$ 54,310,740
Other revenue	531,371	543,474
Total net revenue	54,565,838	54,854,214
Operating expenses:		
Salaries and benefits	23,095,256	21,273,114
Professional services	8,549,413	9,099,695
Supplies	5,831,745	6,139,169
Other operating expenses	6,022,301	5,887,509
Provision for doubtful accounts	2,035,446	2,882,152
Depreciation and amortization	3,287,347	3,555,043
	48,821,508	48,836,682
Income before interest, intercompany fees and income tax provision	5,744,330	6,017,532
Interest expense	1,629,083	2,032,328
Intercompany fees	1,536,097	1,264,688
Income before taxes	2,579,150	2,720,516
Income tax provision	1,006,144	846,933
Net income	\$ 1,573,006	\$ 1,873,583

*See accompanying notes.*

Sharon Hospital Holding Company, Inc.  
and Subsidiaries

Consolidated Statements of Stockholder's Equity

	Common Stock	Retained	Other	Total
	Shares	Earnings	Comprehensive	Stockholder's
	Amount	Loss	Equity	Equity
Balance at September 30, 2008	1,000	\$ 11,528,344	\$ -	\$ 11,529,344
Net income	-	1,873,583	-	1,873,583
Actuarial losses on post retirement healthcare benefit (net of tax benefit)	-	-	(353,878)	(353,878)
Balance at October 1, 2009	1,000	13,401,927	(353,878)	13,049,049
Net income	-	1,573,006	-	1,573,006
Actuarial losses on post retirement healthcare benefit (net of tax benefit)	-	-	(103,099)	(103,099)
Balance at September 30, 2010	1,000	\$ 14,974,933	\$ (456,977)	\$ 14,518,956

See accompanying notes.

Sharon Hospital Holding Company, Inc.  
and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended September 30	
	2010	2009
<b>Operating activities</b>		
Net income	\$ 1,573,006	\$ 1,873,583
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,287,347	3,555,043
Provision for doubtful accounts	2,035,446	2,882,152
Post-retirement benefits	(61,210)	-
Deferred income taxes	(39,605)	(644,982)
Changes in operating assets and liabilities:		
Accounts receivable	(1,735,701)	(2,768,129)
Inventories	(21,847)	(5,696)
Prepaid expenses and other current assets	928,586	(353,126)
Accounts payable and other current liabilities	(705,603)	450,537
Due to third-party payers	(112,560)	227,062
Net cash provided by operating activities	5,147,859	5,216,444
<b>Investing activities</b>		
Decrease in other assets	543	21,476
Purchases of property and equipment	(1,316,502)	(1,136,271)
Net cash used in investing activities	(1,315,959)	(1,114,795)
<b>Financing activities</b>		
Net advances to Parent	(2,800,761)	(2,947,624)
Payments on debt	(350,000)	(350,000)
Capital lease principal payments	(681,139)	(804,025)
Net cash used in financing activities	(3,831,900)	(4,101,649)
Change in cash and cash equivalents	-	-
Cash and cash equivalents, beginning of period	-	-
Cash and cash equivalents, end of period	\$ -	\$ -
<b>Supplemental cash flow information</b>		
Cash paid for interest	\$ 1,629,083	\$ 2,032,328
<b>Non-cash investing activities</b>		
Equipment acquired under capital lease obligations	\$ 90,648	\$ -

*See accompanying notes.*



# Sharon Hospital Holding Company, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

September 30, 2010

### 1. Business and Summary of Significant Accounting Policies

#### Organization

Sharon Hospital Holding Company, Inc. (the Company) is an indirect wholly owned subsidiary of Essent Healthcare, Inc. (the Parent). As of September 30, 2010, the Company through its subsidiaries (Essent Healthcare of Connecticut, Inc. and Regional Healthcare Associates, LLC) owns and operates Sharon Hospital (the Hospital) and physician office practices. These consolidated financial statements include the results of operations of Essent Healthcare of Connecticut, Inc. and Regional Healthcare Associates, LLC for the years ended September 30, 2010 and 2009. The Hospital and physician practices provide healthcare services to patients living in Sharon, Connecticut and the surrounding communities.

#### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

#### Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand less an amount for payments that have not cleared the bank (outstanding checks). At September 30, 2010 and 2009, the amount of outstanding checks exceeded the amount of cash on hand. The net balance of \$712,917 at September 30, 2010 and \$1,264,903 at September 30, 2009, are included in accounts payable and other liabilities in the accompanying consolidated balance sheets. The Company participates in the Parent's cash management system, which provides cash to the Company as outstanding checks clear the bank. Cash and cash equivalents are held in financial institutions that are federally insured. The amount of credit exposure with any one institution is limited.

## Sharon Hospital Holding Company, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Business and Summary of Significant Accounting Policies (continued)

##### Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Sharon Hospital Holding Company Inc., and of subsidiaries and affiliates controlled by the Company. All material intercompany accounts and transactions have been eliminated in consolidation.

##### Net Patient Revenue and Accounts Receivable

The Company has entered into agreements with third-party payors, including government programs and commercial insurers, under which the facilities are paid based upon discounts from established charges, the cost of providing services, predetermined rates per diagnosis, or fixed per diem rates. Revenues are recorded at the time the healthcare services are provided at estimated amounts due from patients and third-party payors. Settlements under reimbursement agreements with third-party payors are estimated and recorded in the period the related services are rendered and are adjusted in future periods as interim or final settlements of amounts are determined. Final determination of certain amounts earned under prospective payment and cost-reimbursement activities is subject to review by appropriate governmental authorities or their agents and may take several years for the final settlements to be determined.

Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is a possibility that recorded estimates may change in the future. The Company 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 that would have a material effect on the Company's financial statements.

Management recognizes that revenue and receivables from government agencies are significant to its operations, but it does not believe that there is significant credit risks associated with these government agencies. The Company performs continual credit evaluations of its accounts receivable and maintains allowances for estimated uncollectible amounts. The Company's determination of uncollectible accounts is based on an assessment of historical and expected net collections, and business and economic conditions prevalent in each operating market and trends in federal and state governmental healthcare coverage. Upon the culmination of reasonable collection efforts, accounts receivable are written-off based upon specific identification.

## Sharon Hospital Holding Company, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **1. Business and Summary of Significant Accounting Policies (continued)**

Approximately 57.2% and 54.3% of the Company's gross charges for the years ended September 30, 2010 and 2009, respectively, were related to patients participating in the Medicare and Medicaid programs.

The Company provides care to patients who are financially unable to pay for the healthcare services they receive. Because the Company does not pursue collection of amounts determined to qualify as charity care, the related charges are not reported as revenue. The amount of charges forgone for services and supplies furnished under the Company's charity care policy aggregated approximately \$767,288 and \$430,330 for the years ended September 30, 2010 and 2009, respectively.

#### **Inventories**

Inventories, principally medical supplies and pharmaceuticals, are stated at the lower of cost (first-in, first-out) or market.

#### **Property and Equipment**

Property and equipment are stated at cost less accumulated depreciation. Routine maintenance and repairs are charged to expense as incurred. Expenditures that increase values, change capacities or extend useful lives are capitalized. Depreciation expense is computed by the straight-line method over the estimated useful lives of the assets, which approximate 3 to 30 years. Depreciation expense, including amortization on assets recorded under capital lease obligations, was \$3,287,347 and \$3,555,043 for the years ended September 30, 2010 and 2009, respectively.

#### **Long-Lived Assets**

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In evaluating possible impairment, the Company uses the most appropriate method of evaluation given the circumstances surrounding the particular asset, which generally has been an estimate of the related asset's undiscounted cash flows, as prescribed by the Financial Accounting Standards Board (the FASB) accounting guidance for the impairment or disposal of long-lived assets. The Company incurred no impairment to the long-lived assets in the years ended September 30, 2010 and 2009.

## Sharon Hospital Holding Company, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Business and Summary of Significant Accounting Policies (continued)

##### Amounts due to/from Parent

Amounts due to/from Parent represent the net excess or deficit of funds transferred to or paid on behalf of the Company over funds transferred to the centralized cash management account of the Parent. Generally, this balance represents funds advanced to acquire the facility, net effect of funds used or provided by the Company during the normal daily cash management process, plus any intercompany charges from the Parent to the Company for management fees. Management fees include an allocation of corporate office expense of \$1,536,097 and \$1,264,689 for the years ended September 30, 2010 and 2009, respectively.

##### Self-Insurance Plan

The Company maintained a self-insured medical and dental plan for employees. Claims were accrued under this plan as the incidents that give rise to them occurred. Unpaid claim accruals are based on the estimated ultimate cost of the claim, including any related expenses, in accordance with the Company's past experience. The Company has entered into a reinsurance agreement with an independent insurance company to limit its losses on claims. The Company remains liable for these claims to the extent that the re-insurer does not meet its obligations.

##### Income Taxes

The Company is a corporation subject to federal and state income taxes. In accordance with the FASB's guidance for accounting for income taxes, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in years in which those temporary differences are expected to be recovered or settled. Under the income tax guidance, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company is included in the consolidated Federal tax return of the Parent. The Parent's tax policy is to allocate a provision for income taxes as if the Company filed a separate return. The state income tax provision for the years ended September 30, 2010 and 2009, were based on the Company's allocable share of the consolidated Connecticut income tax rate for Essent Healthcare, Inc. Obligations related to income taxes of \$966,539 and \$1,309,614 at September 30, 2010 and 2009 respectively, are included in Amounts due from Parent in the accompanying consolidated balance sheets. All income tax payments are paid by the Parent in connection with the consolidated Federal tax obligation.

## Sharon Hospital Holding Company, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Business and Summary of Significant Accounting Policies (continued)

##### Fair Value of Financial Instruments

The carrying amounts reported in the accompanying balance sheets for accounts receivable, prepaid expenses and other current assets, accounts payable, accrued expenses, other current liabilities, and other liabilities approximate fair value. Based on the borrowing rates currently available to the Company, the carrying amounts reported for long-term debt and capital lease obligations approximate fair value.

##### Professional and General Liability Reserves

The Company is insured for professional and general liabilities under the Parent's insurance policies. The Parent insures for professional and general liability risks under a combination of "claims-made" policies. Claims are covered up to at least \$2,000,000 per occurrence and are subject to a \$2,000,000 self-insured retention. The Company paid \$820,000 and \$772,000 in 2010 and 2009 to a subsidiary of the Parent to insure the \$2,000,000 self-insurance retention. Additionally, the Parent has excess liability policies in place to extend coverage to a maximum of \$40,000,000 per occurrence and in the aggregate. The Parent reserves for professional and general liability risks, including estimates for incurred but not reported claims, and allocates such costs to the Company. Professional and general liability costs incurred for the years ended September 30, 2010 and 2009, and recorded in other operating expenses in the consolidated statements of income totaled \$1,381,271 and \$1,227,519 respectively.

##### Recent Accounting Developments

In July 2006, the FASB issued guidance relating to the accounting for uncertainty in income taxes (tax uncertainty guidance). The tax uncertainty guidance clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with the guidance for accounting for income taxes. The guidance also prescribes the recognition of a tax position taken or expected to be taken in a tax return. In addition, the guidance provides rules on derecognition, classification, interest and penalties, accounting, disclosure and transition. The provisions of the tax uncertainty guidance are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of the guidance. The cumulative effect of applying the provisions of the guidance should be reported as an adjustment to the opening balance of retained earnings for that fiscal year. The provisions of the guidance were adopted by the Company on October 1, 2009.

## Sharon Hospital Holding Company, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **1. Business and Summary of Significant Accounting Policies (continued)**

The Company did not have any significant unrecognized tax benefits and there was no material effect on the financial condition or results of operations as a result of implementing the guidance.

In January 2010, the FASB issued updated guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. This update requires new disclosures about significant transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy (including the reasons for these transfers) and the reasons for any transfers in or out of Level 3. This update also requires a reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. In addition to these new disclosure requirements, this update clarifies certain existing disclosure requirements. For example, this update clarifies that reporting entities are required to provide fair value measurement disclosures for each class of assets and liabilities, rather than each major category of assets or liabilities. This update also clarifies the requirement for entities to disclose information about both the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. This update will become effective for the Company with the annual reporting period beginning after December 15, 2010, the Company's fiscal year 2012. The Company will not be required to provide the amended disclosures for any previous periods presented for comparative purposes. Other than requiring additional disclosures, adoption of this update will not have a material impact on the consolidated financial statements.

In August 2010, the FASB issued guidance to amend the insurance claims and related insurance recoveries presentation requirements for health care organizations (insurance claims guidance). Such guidance will require health care organizations to present anticipated insurance recoveries and estimated liabilities for medical malpractice claims or similar contingent liabilities separately on the balance sheet, unless the criteria for offsetting are met. The insurance claims guidance will become effective for the Company with the annual reporting period beginning after December 15, 2010, the Company's fiscal year 2012, through a cumulative effect adjustment as of the beginning of the period of adoption. Additionally, the Company is permitted to elect to apply the guidance retrospectively, and early adoption will be permitted. Adoption of the insurance claims guidance will not have a material impact on the consolidated financial statements.

In August 2010, the FASB issued guidance regarding charity care disclosure requirements for health care organizations (charity care guidance). Such guidance will require health care organizations to disclose the level of charity care provided based on the direct and indirect costs

Sharon Hospital Holding Company, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**1. Business and Summary of Significant Accounting Policies (continued)**

of the charity care services provided. In addition, health care organizations will be required to separately disclose the amount of any cash reimbursements received for providing charity care. The charity care guidance will become effective for the Company with the annual reporting period beginning after December 15, 2010, the Company's fiscal year 2012, through retrospective application to all periods presented. Early adoption will be permitted. Other than requiring additional disclosures, adoption of the charity care guidance will not have a material impact on the consolidated financial statements.

**2. Retirement Benefit Plans**

**Postretirement Benefit Plan**

The Company provides postretirement benefits to eligible former employees of the Hospital who retired prior to August 1, 1994. The Hospital provides supplemental medical and dental coverage to retirees who retired prior to that date. Only those employees grandfathered in the postretirement plan are eligible to participate.

Significant disclosures relating to the postretirement benefit plan (measured as of September 30, 2010 and 2009) follow:

	<u>2010</u>	<u>2009</u>
<b>Components of net periodic benefit cost</b>		
Interest cost	\$ 74,000	\$ 92,000
Amortization of actuarial loss	58,000	9,000
Net periodic benefit cost	<u>\$ 132,000</u>	<u>\$ 101,000</u>
	<u>2010</u>	<u>2009</u>
<b>Change in benefit obligation</b>		
Accumulated benefit obligation at beginning of year	\$ 1,571,000	\$ 1,270,000
Interest cost	74,000	92,000
Benefits paid	(260,000)	(233,000)
Actuarial loss	281,000	442,000
Accumulated benefit obligation at end of year	<u>\$ 1,666,000</u>	<u>\$ 1,571,000</u>

Sharon Hospital Holding Company, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Retirement Benefit Plans (continued)**

	<u>2010</u>	<u>2009</u>
<b>Change in plan assets</b>		
Fair value of plan assets at end of prior year	\$ -	\$ -
Employer contributions	260,000	233,000
Benefits paid	(260,000)	(233,000)
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>
Funded status at year end	<u>\$ (1,666,000)</u>	<u>\$ (1,571,000)</u>
	<u>2010</u>	<u>2009</u>
<b>Amounts recognized in the statement of financial position consists of:</b>		
Current liabilities	\$ (164,000)	\$ (164,000)
Noncurrent liabilities	(1,502,000)	(1,407,000)
Net amount recognized in statement of financial position	<u>\$ (1,666,000)</u>	<u>\$ (1,571,000)</u>
	<u>2010</u>	<u>2009</u>
<b>Weighted-average assumptions used to determine benefit obligations at September 30</b>		
Discount rate	3.94%	4.95%
Measurement date	Sept. 30, 2010	Sept. 30, 2009
Medical cost trend rate assumed for next year	6.50%	6.75%
Ultimate rate	5.00%	5.00%
Year that the rate reaches the ultimate rate	2018-2019	2018-2019
	<u>2010</u>	<u>2009</u>
<b>Expected Cash Flows</b>		
Expected return of assets to employer in next year	\$ -	\$ -
Expected employer contributions for next fiscal year	164,000	163,000



Sharon Hospital Holding Company, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Retirement Benefit Plans (continued)**

	<b>Employer Benefit Payment</b>
Expected benefit payments for fiscal year ending in:	
2011	\$ 164,000
2012	163,000
2013	161,000
2014	158,000
2015	154,000
Next 5 years	674,000

	<b>2010</b>	<b>2009</b>
<b>Effect of 1% Increase in Trend Rates</b>		
Effect on total service cost and interest cost	\$ 5,000	\$ 6,000
Effect on benefit obligation	100,000	69,000
<b>Effect of 1% Decrease in Trend Rates</b>		
Effect on total service cost and interest cost	(4,000)	(5,000)
Effect on benefit obligation	(91,000)	(63,000)

For measurement purposes relating to the postretirement benefit plan for 2010, annual increases in per capita cost of covered health care benefits of 6.50% (grading down to 5.0% after 7 years) were assumed.

## Sharon Hospital Holding Company, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 2. Retirement Benefit Plans (continued)

##### 401(k) Plan

Effective October 1, 1999, the Parent adopted the Essent Healthcare, Inc. 401(k) Plan (the Benefit Plan). Each employee employed on the effective date was deemed eligible to participate. Otherwise, to become eligible, participants must be at least 21 years of age and be employed by the Company. The Company makes matching contributions to the Benefit Plan on a discretionary basis. Matching contributions paid during the year ended September 30, 2010, related to the Plan year 2009 were \$133,729. During fiscal year 2009, the Company decided not to fund an employer match for the Plan year 2008. Accordingly, the Company reduced employee benefits in 2009 by \$229,000. As of September 30, 2010, an accrual for matching contributions in the amount of approximately \$211,000 is included in accrued expenses in the accompanying consolidated balance sheets for matching contributions related to Plan year 2010. For the years ended September 30, 2010 and 2009, the Company recorded \$141,504 and \$(24,111), as an expense (benefit) related to the employer's matching contribution to participants in the Benefit Plan.

#### 3. Debt

##### Credit Facility

On December 20, 2007, the Parent entered into a credit facility which consists of two term loans and a revolving credit loan. The proceeds from the loan were used to retire all the Parent's and the Company's then outstanding term and revolver debt and pay the debt issuance costs incurred in connection with the transaction. One of the term loans, in the amount of \$35,000,000, is an obligation of the Company. This term loan will be repaid in twenty-two consecutive quarterly installments of \$87,500 beginning on March 31, 2008 with a final payment of \$33,075,000 on September 30, 2013. The revolving credit loan matures on September 30, 2013. The interest on the loans will accrue at the Company's option at either base rate (prime) or LIBOR plus an applicable margin. On June 2, 2010 the Parent entered into an agreement to amend the credit facility. The impact on the Company's term loan was to increase the maximum margin from 3.0% to 3.5% for base rate loans and from 4.0% to 4.5% for LIBOR loans. The margins above the prime rate or LIBOR will decrease depending on the Parent's consolidated leverage ratio as defined in the Agreement. At September 30, 2010, the interest rate was 4.26%.

## Sharon Hospital Holding Company, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 3. Debt (continued)

In accordance with the Credit Agreement, the Parent is required to comply with certain covenants including a fixed coverage charge ratio and a leverage ratio. The Parent was in compliance with the covenants as of September 30, 2010. The Company's term loan is secured by a collateral interest in substantially all of the Company's assets.

Considering the terms of the Credit Facility, the Company's scheduled principal payments over the next five years are as follows:

For the year September 30, 2010	Amount
2011	\$ 350,000
2012	350,000
2013	33,337,500

#### 4. Common Stock

The Company issued 1,000 shares of no par Common Stock to EHCO, LLC, a subsidiary of the Parent. Holders of the Common Stock outstanding shall be entitled to one vote per share on all matters to be voted on by the stockholders. The Board may declare a dividend upon the Common Stock out of the unrestricted and unreserved surplus of the Company. As and when dividends are declared or paid thereon, the holders of the Common Stock shall be entitled to receive the balance of such dividends ratably among such holders.

Upon any liquidation of the Company, after payment of all of the Company's debts and obligations, the holders of Common Stock shall be entitled to participate in all distributions. The holders of the Common Stock shall be entitled to receive the balance of such distribution ratably among such holders.

In connection with the acquisition of the Hospital, the Company through its subsidiary issued 1,000 shares of \$.01 par value, non-voting Class B Common Stock (the Shares) of Essent Healthcare of Connecticut, Inc. to the seller. In accordance with the Stockholders Agreement, the Company has the right to call the Shares at any time on and after April 12, 2012, for a total purchase price of \$250,000. The value of the Class B Common Stock is recorded in other long-term liabilities on the consolidated balance sheets.

Sharon Hospital Holding Company, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**5. Capital Lease Obligations**

The Company leases various equipment under lease agreements that have been capitalized with a net book value of \$1,187,661 and \$1,719,620 included in equipment at September 30, 2010 and 2009, respectively. Future minimum lease payments and the present value of future minimum lease payments for capital leases as of September 30, 2010, are as follows:

2011	\$ 604,114
2012	341,267
2013	100,344
2014	72,291
Total future minimum lease payments	<u>1,118,016</u>
Less amounts representing interest	<u>100,156</u>
	1,017,860
Less current portion	<u>547,476</u>
Long-term capital lease obligations	<u>\$ 470,384</u>

**6. Income Taxes**

The income tax provision for the year ended September 30, 2010 and 2009 includes the following components:

	<u>2010</u>	<u>2009</u>
Federal income tax provision (benefit):		
Current	\$ 868,288	\$ 1,202,490
Deferred	39,605	(462,681)
	<u>907,893</u>	<u>739,809</u>
State income tax provision:		
Current	98,251	107,124
	<u>98,251</u>	<u>107,124</u>
	<u>\$ 1,006,144</u>	<u>\$ 846,933</u>

Sharon Hospital Holding Company, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**6. Income Taxes (continued)**

Significant components of the Company's deferred tax assets and liabilities consist of the following at September 30, 2010:

	<u>Current</u>	<u>Noncurrent</u>	<u>Total</u>
Deferred tax assets:			
Accrued expenses	\$ 582,409	\$ 343,988	\$ 926,397
Allowance for doubtful accounts	1,058,375	-	1,058,375
Charitable contribution carryover	-	48,606	48,606
Post retirement	-	235,412	235,412
Total deferred tax assets	<u>1,640,784</u>	<u>628,006</u>	<u>2,268,790</u>
Deferred tax liabilities:			
Property and equipment	-	(1,311,651)	(1,311,651)
Total deferred tax liabilities	<u>-</u>	<u>(1,311,651)</u>	<u>(1,311,651)</u>
Net deferred tax assets (liabilities)	<u>\$ 1,640,784</u>	<u>\$ (683,645)</u>	<u>\$ 957,139</u>

Significant components of the Company's deferred tax assets and liabilities consist of the following at September 30, 2009:

	<u>Current</u>	<u>Noncurrent</u>	<u>Total</u>
Deferred tax assets:			
Accrued expenses	\$ 537,087	\$ 486,206	\$ 1,023,293
Allowance for doubtful accounts	1,090,318	-	1,090,318
Charitable contribution carryover	-	31,380	31,380
Post retirement	-	182,301	182,301
Total deferred tax assets	<u>1,627,405</u>	<u>699,887</u>	<u>2,327,292</u>
Deferred tax liabilities:			
Property and equipment	-	(1,462,869)	(1,462,869)
Total deferred tax liabilities	<u>-</u>	<u>(1,462,869)</u>	<u>(1,462,869)</u>
Net deferred tax assets (liabilities)	<u>\$ 1,627,405</u>	<u>\$ (762,982)</u>	<u>\$ 864,423</u>

## Sharon Hospital Holding Company, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 6. Income Taxes (continued)

The Company's effective tax rate differed from the federal statutory rate as set forth below:

	<u>2010</u>	<u>2009</u>
Tax at U.S. statutory rates	\$ 876,911	\$ 924,975
State taxes, net of federal benefits	64,737	70,702
Other	64,496	(148,744)
Total	<u>\$ 1,006,144</u>	<u>\$ 846,933</u>

#### 7. Contingencies and Healthcare Regulations

The Company is subject to various claims and lawsuits arising in the normal course of business. In the opinion of management, the ultimate resolution of these matters will not have a material effect on the Company's financial position or results of operations.

##### Healthcare Regulations

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries are outstanding, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Company.

Sharon Hospital Holding Company, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**7. Contingencies and Healthcare Regulations (continued)**

**Operating Leases**

The Company leases office facilities and certain equipment under noncancellable operating leases that expire at various dates through 2012. As of September 30, 2010, the future minimum lease commitments under these noncancellable leases are as follows:

2011	\$ 89,422
2012	56,323
2013	28,397
2014 and thereafter	20,161
Total minimum rental payments	<u>\$ 194,303</u>

Total rental expense amounted to approximately \$469,551 and \$477,472 for the years ended September 30, 2010 and 2009, respectively.

**8. Subsequent Events**

The Company has evaluated all material events subsequent to the balance sheet date through January 12, 2011, for events requiring disclosure or recognition in the consolidated financial statements. There were not subsequent events requiring disclosure or recognition in the consolidated financial statements.

## Other Financial Information



## Report of Independent Auditors on Other Financial Information

The Board of Directors  
Sharon Hospital Holding Company, Inc. and Subsidiaries

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying consolidating financial information as of and for the year ended September 30, 2010 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

*Ernst + Young LLP*

January 12, 2011

Consolidated Sharon Hospital Holding Company, Inc.

Consolidating Balance Sheet

Year Ended September 30, 2010

	Sharon Hospital Holding Co., Inc.	Connecticut, Inc.	Essent Healthcare of Healthcare of	Regional Healthcare Associates, LLC	Eliminations	Consolidated Sharon Hospital Holding Co., Inc.
<b>Assets</b>						
Current assets:						
Patient accounts receivable, net of allowance for doubtful accounts of \$4,034,864	\$ -	\$ 5,879,926	\$ -	\$ 362,499	\$ -	\$ 6,242,425
Inventories	-	1,162,381	-	-	-	1,162,381
Prepaid expenses and other receivables	-	598,277	-	-	-	598,277
Deferred income taxes	-	1,640,784	-	-	-	1,640,784
Total current assets	-	9,281,368	-	362,499	-	9,643,867
Property and equipment:						
Land and land improvements	-	1,797,359	-	-	-	1,797,359
Buildings	-	39,050,328	-	341,270	-	39,391,598
Equipment	-	17,006,422	-	495,012	-	17,501,434
Construction in progress	-	242,040	-	-	-	242,040
Less accumulated depreciation	-	58,096,149	-	836,282	-	58,932,431
	-	(19,433,867)	-	(374,073)	-	(19,807,940)
	-	38,662,282	-	462,209	-	39,124,491
Amounts due from (to) Parent and Affiliate	1,000	12,574,920	-	(4,546,194)	-	8,029,726
Other	-	493,086	-	9,003	-	502,089
<b>Total assets</b>	<b>\$ 1,000</b>	<b>\$ 61,011,656</b>	<b>\$ (3,712,483)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 57,300,173</b>

Consolidated Sharon Hospital Holding Company, Inc.

Consolidating Balance Sheet (continued)

Year Ended September 30, 2010

	Sharon Hospital Holding Co., Inc.	Connecticut, Inc.	Essent Healthcare of Healthcare of	Regional Healthcare Associates, LLC	Eliminations	Consolidated Sharon Hospital Holding Co., Inc.
<b>Liabilities and stockholder's equity (deficit)</b>						
Current liabilities:						
Accounts payable and other liabilities	\$	-	\$ 1,338,667	\$ 32,068	\$	1,370,735
Other accrued expenses	-	-	3,591,616	5,315	-	3,596,931
Due to third-party payors	-	-	322,546	-	-	322,546
Current portion of capital lease obligations	-	-	547,476	-	-	547,476
Current portion of long-term debt	-	-	350,000	-	-	350,000
Total current liabilities	-	-	6,150,305	37,383	-	6,187,688
Accrued post-retirement benefits	-	-	1,502,000	-	-	1,502,000
Deferred income taxes	-	-	683,645	-	-	683,645
Capital lease obligations, less current portion	-	-	470,384	-	-	470,384
Long-term debt, less current portion	-	-	33,687,500	-	-	33,687,500
Other	-	-	250,000	-	-	250,000
Stockholder's equity (deficit):						
Common stock; no par; 1,000 shares authorized; 1,000 shares issued and outstanding	1,000	-	-	-	-	1,000
Other comprehensive loss	-	-	(456,977)	-	-	(456,977)
Retained earnings (deficit)	-	-	18,724,799	(3,749,866)	-	14,974,933
Total stockholder's equity (deficit)	1,000	-	18,267,822	(3,749,866)	-	14,518,956
Total liabilities and stockholder's equity (deficit)	\$ 1,000	\$ 61,011,656	\$ (3,712,483)	\$	\$	\$ 57,300,173

# Consolidated Sharon Hospital Holding Company, Inc.

## Consolidating Statement of Operations

Year Ended September 30, 2010

	Sharon Hospital Holding Co., Inc.	Essent Healthcare of Connecticut, Inc.	Regional Healthcare Associates, LLC	Consolidated Sharon Hospital Holding Co., Inc.
Net revenues:				
Net patient revenue	-	\$ 50,495,530	\$ 3,538,937	\$ 54,034,467
Other revenue	-	530,398	973	531,371
Total net revenue	-	51,025,928	3,539,910	54,565,838
Operating expenses:				
Salaries and benefits	-	19,414,774	3,680,482	23,095,256
Professional services	-	7,634,396	915,017	8,549,413
Supplies	-	5,689,724	142,021	5,831,745
Other operating expenses	-	5,609,902	412,399	6,022,301
Provision for doubtful accounts	-	1,748,130	287,316	2,035,446
Depreciation and amortization	-	3,147,818	139,529	3,287,347
Income (loss) before interest, intercompany fees and income taxes	-	43,244,744	5,576,764	48,821,508
Interest expense	-	7,781,184	(2,036,854)	5,744,330
Intercompany fees	-	1,629,083	-	1,629,083
Income before taxes	-	1,536,097	-	1,536,097
Income tax expense (benefit)	-	4,616,004	(2,036,854)	2,579,150
Net income	-	1,698,674	(692,530)	1,006,144
	-	\$ 2,917,330	\$ (1,344,324)	\$ 1,573,006

Ernst & Young LLP

Assurance | Tax | Transactions | Advisory

**About Ernst & Young**

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 130,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve potential.

[www.ey.com](http://www.ey.com)

