AUDITED FINANCIAL STATEMENTS

Lakewood Hospital Association
Years Ended December 31, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

ERNST & YOUNG

Lakewood Hospital Association

Audited Financial Statements

Years Ended December 31, 2012 and 2011

Contents

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Report of Independent Auditors

The Board of Trustees
Lakewood Hospital Association

We have audited the accompanying financial statements of Lakewood Hospital Association, which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

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.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lakewood Hospital Association at December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

May 29, 2013

Lakewood Hospital Association

Balance Sheets
(In Thousands)

	December 31 2012	2011
Assets		
Current assets:		
Cash and cash equivalents	**$ 4,348**	$ 3,612
Patient receivables, net of allowances for uncollectible accounts of $3,246 in 2012 and $4,291 in 2011	**15,315**	12,649
Other current assets	**8,684**	10,190
Total current assets	**28,347**	26,451
Investments:		
Long-term investments	**45,110**	46,008
Funds held by bond trustees	**3,180**	3,179
Donor restricted assets	**3,274**	2,903
	51,564	52,090
Property, plant, and equipment, net	**49,758**	49,767
Interest in Lakewood Hospital Foundation, Inc.	**27,964**	25,844
Other assets:		
Pledges receivable, net	**608**	1,193
Other noncurrent assets	**1,064**	1,319
	1,672	2,512
Total assets	**$ 159,305**	$ 156,664

	December 31	
	2012	**2011**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 4,972**	$ 4,616
Compensation and amounts withheld from payroll	**4,870**	4,820
Estimated amounts due to third-party payors	**1,316**	538
Current portion of long-term debt	**3,122**	2,959
Other current liabilities	**2,376**	1,879
Total current liabilities	**16,656**	14,812
Long-term debt:		
Hospital revenue bonds	**8,309**	11,125
Notes payable and capital leases	**10,640**	11,117
	18,949	22,242
Other liabilities	**589**	252
Total liabilities	**36,194**	37,306
Net assets:		
Unrestricted	**88,120**	86,756
Temporarily restricted	**19,056**	17,230
Permanently restricted	**15,935**	15,372
Total net assets	**123,111**	119,358
Total liabilities and net assets	**$ 159,305**	$ 156,664

See accompanying notes.

Lakewood Hospital Association

Statements of Operations and
Changes in Net Assets
(In Thousands)

	Year Ended December 31	
	2012	**2011**
Unrestricted revenues		
Net patient service revenue	**$ 140,648**	$ 144,778
Provision for uncollectible accounts	**(11,896)**	(15,522)
Net patient service revenue less provision for uncollectible accounts	**128,752**	129,256
Other	**5,462**	9,358
Total unrestricted revenues	**134,214**	138,614
Expenses		
Salaries, wages, and benefits	**71,510**	70,437
Supplies	**15,102**	15,880
Pharmaceuticals	**4,355**	4,092
Purchased services and other fees	**6,851**	6,204
Administrative services	**23,043**	23,810
Facilities	**8,988**	9,408
Insurance	**886**	1,396
	130,735	131,227
Operating income before interest, depreciation, and amortization expenses	**3,479**	7,387
Interest	**1,139**	1,259
Depreciation and amortization	**6,622**	6,861
Operating loss	**(4,282)**	(733)
Nonoperating gains and losses		
Investment return	**5,644**	1,170
Other, net	**(50)**	(55)
Net nonoperating gains and losses	**5,594**	1,115
Excess of revenues over expenses	**1,312**	382

Continued on next page.

Lakewood Hospital Association

Statements of Operations and Changes in Net Assets (continued)

(In Thousands)

	Net Assets			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Balances at December 31, 2010	$ 86,007	$ 16,820	$ 13,253	$ 116,080
Excess of revenues over expenses	382	–	–	382
Net assets released from restrictions for capital	367	(367)	–	–
Gifts and bequests	–	742	–	742
Net investment income	–	159	–	159
Net assets released from restrictions used for operations included in other unrestricted revenues	–	(394)	–	(394)
Change in interest in Lakewood Hospital Foundation, Inc.	–	270	2,078	2,348
Change in value of perpetual trusts	–	–	41	41
Increase in net assets	749	410	2,119	3,278
Balances at December 31, 2011	86,756	17,230	15,372	119,358
Excess of revenues over expenses	**1,312**	**–**	**–**	**1,312**
Net assets released from restrictions for capital	**52**	**(52)**	**–**	**–**
Gifts and bequests	**–**	**313**	**–**	**313**
Net investment income	**–**	**407**	**–**	**407**
Net assets released from restrictions used for operations included in other unrestricted revenues	**–**	**(258)**	**–**	**(258)**
Change in interest in Lakewood Hospital Foundation, Inc.	**–**	**1,416**	**704**	**2,120**
Change in value of perpetual trusts	**–**	**–**	**(141)**	**(141)**
Increase in net assets	**1,364**	**1,826**	**563**	**3,753**
Balances at December 31, 2012	**$ 88,120**	**$ 19,056**	**$ 15,935**	**$ 123,111**

See accompanying notes.

Lakewood Hospital Association

Statements of Cash Flows
(In Thousands)

	Year Ended December 31 2012	2011
Operating activities		
Increase in net assets	**$ 3,753**	$ 3,278
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Change in interest in Lakewood Hospital Foundation, Inc.	**(2,120)**	(2,348)
Net realized and unrealized gains on investments	**(5,360)**	(456)
Income from equity investee	**(238)**	(763)
Depreciation and amortization	**6,622**	6,861
Provision for uncollectible accounts	**11,896**	15,522
Restricted gifts, bequests, and investment income	**(720)**	(901)
Change in value of perpetual trusts	**141**	(41)
Amortization of bond premium	**(171)**	(171)
Changes in operating assets and liabilities:		
Patient receivables	**(14,562)**	(14,653)
Other assets	**2,480**	(4,109)
Accounts payable and other current liabilities	**1,114**	(636)
Other liabilities	**337**	69
Net cash provided by operating activities	**3,172**	1,652
Financing activities		
Principal payments on long-term debt	**(2,959)**	(3,072)
Change in pledges receivable	**(40)**	977
Restricted gifts, bequests, and investment income	**720**	901
Net cash used in financing activities	**(2,279)**	(1,194)
Investing activities		
Expenditures for property and equipment	**(6,043)**	(5,519)
Net change in cash equivalents reported in long-term investments	**(61)**	(170)
Purchases of investments	**(553)**	(741)
Sales of investments	**6,500**	9,000
Net cash (used in) provided by investing activities	**(157)**	2,570
Increase in cash and cash equivalents	**736**	3,028
Cash and cash equivalents at beginning of year	**3,612**	584
Cash and cash equivalents at end of year	**$ 4,348**	$ 3,612

See accompanying notes.

1. Organization

Lakewood Hospital Association (the Hospital) is a short-term, acute-care general hospital located in Lakewood, Ohio, offering an expansive range of services from routine inpatient care to the higher levels of acuity care, such as joint replacement surgery, neurosurgery, MRI, major vascular procedures, and numerous specialized medical care capabilities. The Hospital also provides continuum of care services through its inpatient rehabilitation program, skilled nursing unit, and a broad spectrum of specialized community-oriented programs.

The Hospital is a tax-exempt, nonprofit Ohio corporation organized and operated to provide medical and hospital care. In March 1997, the Hospital entered into an agreement with The Cleveland Clinic Foundation (Foundation), whereby the Foundation became the sole corporate member of the Hospital.

The City of Lakewood, Ohio (the City) leases real and personal property to the Hospital for the purpose of operating the Hospital under the terms of the Hospital Revenue Bonds (Note 12). The real and personal property are included in the Hospital's balance sheets as of December 31, 2012 and 2011. The lease between the City and the Hospital, originally executed in 1987, was amended in 1996 (Amended Lease). The term of the Amended Lease is 30 years, and the Hospital has the option to renew the Amended Lease for an additional 30-year term. At the end of the lease term, the real and personal property and all monies, accounts, and inventories then held by the Hospital shall be returned to the City. As part of the Amended Lease, the Hospital has agreed to pay in each year the amount necessary to satisfy debt service on the Hospital's outstanding debt. In addition, in consideration for entering into the Amended Lease, the Hospital has agreed to certain additional payments to the City (Note 13).

2. Affiliations

Lakewood Hospital Foundation, Inc. (LHF) is a not-for-profit organization whose purpose is to seek private gifts to support the work and activities of the Hospital. LHF and the Hospital are deemed to be financially interrelated organizations. Accordingly, the Hospital records its interest in the net assets of LHF as a noncurrent asset and as temporarily and permanently restricted net assets, as appropriate.

2. Affiliations (continued)

The Hospital has a joint-venture agreement with Fairview Hospital, a subsidiary of the Foundation, whereby each party owns 50% of Westlake Imaging Center, LLC (WIC). WIC provides radiology services and began operations in July 2003. The Hospital's investment in WIC is $0.4 million and $0.5 million at December 31, 2012 and 2011, respectively, and is recorded in other noncurrent assets in the balance sheets. The Hospital accounts for its investment in WIC using the equity method of accounting and has recorded its 50% share of WIC's earnings of $0.2 million and $0.8 million in 2012 and 2011, respectively, in other unrestricted revenue. The Hospital received distributions of $0.3 million and $0.7 million from WIC in 2012 and 2011, respectively, representing the Hospital's return on the investment.

3. Accounting Policies

Recent Accounting Pronouncement Adopted

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2011-04 to amend the requirement for measuring and disclosing information about fair value that results in common principles between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards. The amendments clarify the FASB's intent about the application of existing fair value measurement and disclosure requirements and change particular principles and requirements for measuring or disclosing information about fair value. Principles changed include measuring fair value of financial instruments that are managed within a portfolio, application of premiums and discounts in the fair value measurement, and additional disclosures about fair value measurements. The standard became effective for the Hospital for annual reporting periods beginning after December 15, 2011. The Hospital adopted the provisions of this standard on January 1, 2012. The adoption had no impact on previously reported excess of revenues over expenses or net assets.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

3. Accounting Policies (continued)

Net Patient Service Revenue and Patient Receivables

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others, including retroactive adjustments under payment agreements with third-party payors. The Hospital has agreements with third-party payors that generally provide for payments to the Hospital at amounts different from its established rates. For uninsured patients who do not qualify for charity care, the Hospital recognizes revenue based on established rates, subject to certain discounts as determined by the Hospital. An estimated provision for uncollectible accounts is recorded that results in net patient service revenue being reported at the net amount expected to be received. The Hospital has determined, based on an assessment at the entity level, that patient service revenue is primarily recorded prior to assessing the patient's ability to pay and as such, the entire provision for uncollectible accounts related to patient revenue is recorded as a deduction from patient service revenue in the accompanying statements of operations and changes in net assets.

The Hospital is paid a prospectively determined rate for the majority of inpatient acute care and outpatient, skilled nursing and rehabilitation services provided (principally Medicare, Medicaid, and certain insurers). These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for capital are received on a prospective basis for Medicare and a cost reimbursement methodology for Medicaid. The Hospital is paid for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Administrative Contractor. Provision for estimated retroactive adjustments, if any, resulting from regulatory matters or other adjustments under payment agreements are estimated in the period the related services are provided. The Hospital recorded a decrease in net patient service revenue of $0.9 million in 2012 and an increase in net patient service revenue of $0.2 million in 2011, respectively, related to changes in estimates.

The Hospital was a party to a settlement agreement dated April 5, 2012 with the United States Department of Health and Human Services (HHS), the Secretary of HHS and the Centers for Medicare and Medicaid Services (CMS). The Hospital, along with a group of other Medicare providers, had challenged CMS' implementation of the rural floor neutrality provisions of the Balanced Budget Act of 1997, which effectively understated the amount paid through the inpatient prospective payment system for a number of years. Under the settlement agreement, the Hospital received $1.4 million and recognized this amount as net patient service revenue for the year ended December 31, 2011 in the accompanying statements of operations and changes in net assets. Related professional fees of $0.3 million are included in administrative services for the year ended December 31, 2011 in the accompanying statements of operations and changes in net assets.

3. Accounting Policies (continued)

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation as well as significant regulatory action, and, in the normal course of business, the Hospital is subject to contractual reviews and audits, including audits initiated by the Medicare Recovery Audit Contractor program. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Hospital believes it is in compliance with applicable laws and regulations governing the Medicare and Medicaid programs and that adequate provisions have been made for any adjustments that may result from final settlements.

Patient receivables are reduced by an allowance for uncollectible accounts. The allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, major payor sources and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category. The results of this review are then used to make modifications to the provision for uncollectible accounts to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the Hospital follows established guidelines for placing certain past due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by the Hospital.

Electronic Health Record Incentive Program

CMS implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The Medicare EHR incentive program provides incentive payments to eligible professionals, eligible hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology. The Hospital utilizes a grant accounting model to recognize EHR incentive revenues. The Hospital records EHR incentive revenue ratably throughout the incentive reporting period when it is reasonably assured that it will meet the meaningful use objectives for the required reporting period and that the grants will be received. The EHR reporting period for hospitals is based on the federal fiscal year, which runs from October 1 through September 30. The Hospital met the meaningful use objectives for

3. Accounting Policies (continued)

Medicare and Medicaid for the federal fiscal year ended September 30, 2012. The Hospital believes that it will continue to meet these objectives for the federal fiscal year ending September 30, 2013. Therefore, for the year ended December 31, 2012, the Hospital has accrued EHR revenues for the incentive reporting period related to the federal fiscal year ending September 30, 2013. In 2012, the Hospital recorded EHR incentive revenues of $0.5 million, comprised of $0.4 million of Medicare revenues and $0.1 million of Medicaid revenues. In 2011, the Hospital recorded EHR incentive revenues of $2.9 million, comprised of $2.1 million of Medicare revenues and $0.8 million of Medicaid revenues. EHR incentive revenues are included in other unrestricted revenues in the accompanying statements of operations and changes in net assets. EHR incentive receivables from Medicare and Medicaid, which are included in other current assets, were $0.1 million and $0.1 million, respectively, at December 31, 2012. EHR incentive receivables from Medicare and Medicaid were $2.1 million and $0.4 million, respectively, at December 31, 2011.

Charity Care

The Hospital provides care to patients who do not have the ability to pay and who qualify for charity services pursuant to established policies of the Hospital. Charity services are defined as those for which patients have the obligation and willingness to pay but do not have the ability to do so. The Hospital does not include charity care in net patient service revenue. The cost of charity care provided in 2012 and 2011 approximated $8.2 million and $6.8 million, respectively. The Hospital estimated these costs by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients.

The Hospital participates in the Hospital Care Assurance Program (HCAP). Ohio created HCAP to financially support those hospitals that service a disproportionate share of low-income patients unable to pay for care. HCAP funds basic, medically necessary hospital services for patients whose family income is at or below the federal poverty level, which includes Medicaid patients and patients without health insurance. The Hospital recorded HCAP revenues of $1.9 million and $1.5 million for the years ended December 31, 2012 and 2011, respectively, which is included in net patient service revenue in the accompanying statements of operations and changes in net assets.

3. Accounting Policies (continued)

Cash and Cash Equivalents

Cash equivalents include short-term investments with maturities when purchased of three months or less. They also include the Hospital's share in the Foundation's Short-Term Investment Pool (STIP). The STIP consolidates the management and control of cash and cash equivalents of the Foundation and certain of its controlled affiliates. The STIP primarily consists of money market and overnight investments. Interest earnings are allocated to the participants based on the participants' relative share of the total STIP. Interest earnings averaged 0.1% in both 2012 and 2011. The Hospital's share of the STIP is $4.3 million and $3.6 million at December 31, 2012 and 2011, respectively.

Inventories

Inventories (primarily supplies and pharmaceuticals) are stated at an average cost or the lower of cost (first-in, first-out method) or market and are recorded in other current assets.

Other Current Assets

Other current assets consist primarily of inventories, prepaid expenses, pledges receivable, and EHR incentive receivables.

Property, Plant, and Equipment

Property, plant, and equipment purchased by the Hospital are stated at cost. Donated property, plant, and equipment are recorded at fair value at the date of donation. Expenditures which substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation, including amortization of capital leased assets, is computed by the straight-line method using the estimated lives of individual assets. Buildings and building components are assigned a useful life ranging from five years to forty years. Equipment is assigned a useful life ranging from three to fifteen years. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets.

3. Accounting Policies (continued)

Bond Financing Costs

Bond financing costs are amortized over the period the obligation is outstanding using the straight-line method, which approximates the interest method. Unamortized bond financing costs included in other noncurrent assets approximated $88,000 and $129,000 at December 31, 2012 and 2011, respectively.

Other Current and Noncurrent Liabilities

Other current liabilities include patient account credit balances, accrued interest payable, and state franchise fee liability.

Other noncurrent liabilities, net of current portion, consist of deferred revenue and amounts due to third-party payors.

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value in the balance sheets and are primarily classified as trading. Investment transactions are recorded on a settlement date basis. Realized gains and losses are determined using the average cost method.

Investments include the Hospital's share in the Foundation's Long-Term Investment Pool (LTIP). The LTIP consolidates the management and control of the investment assets of the Foundation and certain of its controlled affiliated entities. Participating entities purchase units of the LTIP at market value. All investment earnings, including dividends, interest, realized and unrealized gains and losses, and investment-related expenses are allocated to participants based on their units held. The LTIP primarily consists of equity and debt securities with readily determinable fair values and direct alternative investments (hedge funds, private equity, and real estate), which are reported using the equity method of accounting. LTIP units are valued based on the underlying fair value of the LTIP assets (Note 8).

Return on investments, including equity method income on alternative investments, is reported as nonoperating gains and losses except for earnings on funds held by bond trustees, which are included in other unrestricted revenues. Donor restricted investment return on temporarily and permanently restricted investments are included in temporarily restricted net assets.

3. Accounting Policies (continued)

Certain of the Hospital's assets and liabilities are exposed to various risks such as interest rate, market, and credit risks.

Fair Value Measurements

Fair value measurements are defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Authoritative guidance provides an option to elect fair value as an alternative measurement for selected financial assets and liabilities not previously recorded at fair value. The Hospital did not elect fair value accounting for any assets or liabilities that are not currently required to be measured at fair value.

The framework for measuring fair value is comprised of a three-level hierarchy based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 – inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

3. Accounting Policies (continued)

Contributions

Unconditional donor pledges to give cash, marketable securities, and other assets are reported at fair value at the date the pledge is made to the extent estimated to be collectible by the Hospital. Conditional donor promises to give and indications of intentions to give are not recognized until the condition is satisfied. Pledges received with donor restrictions that limit the use of the donated assets are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are transferred to unrestricted net assets and reported in the statements of operations and changes in net assets as other unrestricted revenues if the purpose relates to operations, or reported as a change in unrestricted net assets if the purpose relates to capital.

No amounts have been reflected in the financial statements for donated services. The Hospital pays for most services requiring specific expertise. However, many individuals volunteer their time and perform a variety of tasks that assist the Hospital with various programs.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the Hospital. Temporarily restricted gifts and bequests are recorded as an addition to temporarily restricted net assets in the period received. Permanently restricted net assets consist of amounts held in perpetuity or for terms designated by donors, including the fair value of a perpetual trust for which the Hospital is an income beneficiary. Earnings on permanently restricted net assets are primarily restricted for various hospital programs.

Excess of Revenues Over Expenses

The statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions, which by donor restriction, were to be used for the purpose of acquiring such assets).

4. Net Patient Service Revenue and Patient Receivables

Net patient service revenue before the provision for uncollectible accounts by major payor source for the years ended December 31, 2012 and 2011, are as follows (in thousands):

	2012		2011	
Medicare	**$ 56,844**	**40%**	$ 59,707	41%
Medicaid	**13,480**	**10**	10,586	7
Managed care and commercial	**51,299**	**36**	52,975	37
Self-pay	**19,025**	**14**	21,510	15
	$ 140,648	**100%**	$ 144,778	100%

For patient receivables associated with self-pay patients, including patients with deductible and copayment balances for which third-party coverage provides for a portion of the services provided, the Hospital records an estimated provision for uncollectible accounts in the year of service. The allowance for uncollectible accounts for self-pay patients as a percentage of self-pay accounts receivable increased from 88% at December 31, 2011 to 90% at December 31, 2012. Self-pay write-offs decreased $2.0 million in 2012 compared to 2011. The Hospital does not maintain a material allowance for uncollectible accounts from third-party payors.

The Hospital's concentration of credit risk relating to patient receivables is limited due to the diversity of patients and payors. Patient receivables consist of amounts due from government programs, commercial insurance companies, private pay patients, and other group insurance programs. Patient receivables due from the Medicare and Medicaid programs, and one commercial payor represents approximately 41%, 6%, and 11% at December 31, 2012 and 39%, 8%, and 9% at December 31, 2011, respectively, of the Hospital's total patient receivables. Revenues from the Medicare and Medicaid programs and one commercial payor accounted for approximately 40%, 10%, and 17%, respectively, in 2012, and 41%, 7%, and 17%, respectively, in 2011 of the Hospital's net patient service revenue. Excluding these payors, no one payor source represents more than 10% of the Hospital's patient receivables or net patient service revenue.

5. Temporarily Restricted Net Assets

Temporarily restricted net assets are comprised of the following at December 31, 2012 and 2011, (in thousands):

	2012	2011
Pledges receivable	**$ 3,381**	$ 3,341
Plant replacement and expansion funds	**1,737**	1,587
Specific-purpose funds	**1,537**	1,317
Interest in Lakewood Hospital Foundation, Inc.'s temporarily restricted net assets	**12,401**	10,985
	$ 19,056	$ 17,230

6. Permanently Restricted Net Assets

Permanently restricted net assets are comprised of the following at December 31, 2012 and 2011, (in thousands):

	2012	2011
Interest in Lakewood Hospital Foundation, Inc.'s permanently restricted net assets	**$ 15,563**	$ 14,859
Perpetual trust	**372**	513
	$ 15,935	$ 15,372

7. Cash, Cash Equivalents, and Investments

The composition of cash, cash equivalents, and investments at December 31, 2012 and 2011, is as follows (in thousands):

	2012	2011
Cash and cash equivalents	**$ 8,329**	$ 7,494
Cleveland Clinic Foundation Long-Term Investment Pool	**47,583**	48,208
Total cash, cash equivalents, and investments	**$ 55,912**	$ 55,702

7. Cash, Cash Equivalents, and Investments (continued)

Total investment return, including LTIP earnings allocated to the Hospital, is comprised of the following for the years ended December 31, 2012 and 2011 (in thousands):

	2012	2011
Nonoperating gains, net:		
Interest income and dividends	**$ 665**	$ 874
Net realized gains on sales of investments	**1,128**	1,121
Net change in unrealized (losses) gains on investments	**2,629**	(985)
Equity method income on alternative investments	**1,355**	318
Investment management fees	**(133)**	(158)
	5,644	1,170
Other changes in net assets:		
Investment income on restricted investments	**407**	159
	$ 6,051	$ 1,329

8. Fair Value Measurements

The carrying values of accounts receivable and accounts payable are reasonable estimates of fair value due to the short-term nature of these financial instruments. Investments held by the LTIP, other than alternative investments, are recorded at their fair value. Other noncurrent assets and liabilities have carrying values that approximate fair value.

The fair value of the Hospital's pledges receivable is based on discounted cash flow analysis using treasury yield curve interest rates consistent with the maturities of the pledges receivable and adjusted for consideration of the donor's credit. The fair value of pledges receivable was $3.4 million (see carrying value at Note 10) at both December 31, 2012 and 2011. Pledges receivable would be classified as Level 3 in the fair value hierarchy.

The fair value of the Hospital's long-term debt is estimated by discounted cash flow analyses using current borrowing rates for similar types of borrowing arrangements and adjusted for the System's credit. Inputs, which include reported/comparable trades, broker/dealer quotes, bids and offerings, are obtained from various sources, including market participants, dealers, brokers and various news media/market information. The fair value of long-term debt was $10.7 million and $13.6 million (see carrying value at Note 12) at December 31, 2012 and 2011, respectively. Long-term debt would be classified as Level 2 in the fair value hierarchy.

8. Fair Value Measurements (continued)

The Hospital's share of the LTIP was $47.6 million and $48.2 million at December 31, 2012 and 2011, respectively. The following tables present the financial instruments that comprise the LTIP measured at fair value on a recurring basis based on the valuation hierarchy:

December 31, 2012	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Investments:				
Cash and cash equivalents	**3%**	**–%**	**–%**	**3%**
Fixed income securities:				
U.S. treasuries	**25**	–	–	**25**
U.S. government agencies	–	<1	–	<1
U.S. corporate	–	**4**	–	**4**
U.S. government agencies asset-backed	–	<1	–	<1
Corporate asset-backed securities	–	–	–	–
Foreign	–	**1**	–	**1**
Commingled fixed income funds	–	**16**	–	16
Common and preferred stocks:				
U.S.	**15**	<1	–	**15**
Foreign	**14**	–	–	**14**
Commingled equity funds	–	**22**	–	**22**
Total investments	**57%**	**43%**	**%**	**100%**

December 31, 2011	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Investments:				
Cash and cash equivalents	6%	–%	–%	6%
Fixed income securities:				
U.S. treasuries	25	–	–	25
U.S. government agencies	–	<1		<1
U.S. corporate	–	7	–	7
U.S. government agencies asset-backed	–	<1	–	<1
Corporate asset-backed securities	–	<1	–	<1
Foreign	–	1	–	1
Commingled fixed income funds	–	15	–	15
Common and preferred stocks:				
U.S.	19	<1	–	19
Foreign	11	<1	–	11
Commingled equity funds	–	16	–	16
Total investments	61%	39%	–%	100%

8. Fair Value Measurements (continued)

The following tables present the financial instruments measured at fair value on a recurring basis, exclusive of the Hospital's share of the LTIP, as of December 31, 2012 and 2011, based on the valuation hierarchy (in thousands):

December 31, 2012	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	**$ 8,329**	**$ –**	$ –	**$ 8,329**
Perpetual trust	**–**	**372**	**–**	**372**
Total	**$ 8,329**	**$ 372**	$ –	**$ 8,701**

December 31, 2011	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	$ 7,494	$ –	$ –	$ 7,494
Perpetual trust	–	513	–	513
Total	$ 7,494	$ 513	$ –	$ 8,007

The Hospital's perpetual trust is reported in other noncurrent assets on the balance sheets. Other noncurrent assets include $0.7 million and $0.8 million at December 31, 2012 and 2011, respectively, of assets that are not measured at fair value on a recurring basis.

The following is a description of the Hospital's and LTIP's valuation methodologies for assets and liabilities measured at fair value. Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is determined as follows:

Investments classified as level 2 are primarily determined using techniques that are consistent with the market approach. Valuations are 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, which include broker/dealer quotes, reported/comparable trades and benchmark yields, are obtained from various sources, including market participants, dealers, and brokers.

The fair value of the perpetual trust is determined based on the present value of expected cash flows to be received from the trust using a discount rate of 5.0% and 3.9% at December 31, 2012 and 2011, respectively, which is based on Treasury yield curve rates and adjusted based on the assumed yield of the trust assets.

8. Fair Value Measurements (continued)

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

9. Property, Plant, and Equipment

Property, plant, and equipment are comprised of the following at December 31, 2012 and 2011 (in thousands):

	2012	2011
Land and improvements	**$ 4,109**	$ 4,109
Buildings	**110,712**	124,761
Equipment	**33,033**	45,389
Construction-in-progress	**504**	390
Computer hardware and software	**9,689**	10,537
	158,047	185,186
Accumulated depreciation	**(108,289)**	(135,419)
	$ 49,758	$ 49,767

10. Pledges Receivable

Outstanding pledges receivable at December 31, 2012 and 2011, are as follows (in thousands):

	2012	2011
Pledges due:		
In less than one year	**$ 2,905**	$ 2,250
In one to five years	**678**	1,353
	3,583	3,603
Present value discount	**(40)**	(99)
Allowance for uncollectible pledges	**(162)**	(163)
Current portion (net of allowance for uncollectible pledges)	**(2,773)**	(2,148)
	$ 608	$ 1,193

11. Captive Insurance Company

The Hospital's professional liability and commercial general liability risks are insured by CCHS Indemnity Co., Ltd. (CCHSICo), a captive insurance company and a controlled affiliated entity of the Foundation. CCHSICo provides professional and general liability insurance coverage on a claims-made basis. The Hospital does not have any uninsured risk related to general and professional liability claims. CCHSICo has reinsurance arrangements in place relative to a portion of the risks. Annual premiums charged to the Hospital are based upon an actuarially determined allocation of the total premium assessed to all of the Foundation's affiliates, which are insured by CCHSICo.

In the ordinary course of business, professional and general liability claims have been asserted against the Hospital by various claimants. These claims are in various stages of processing or, in certain instances, are in litigation. In addition, there are known incidents, and there may also be unknown incidents, which may result in the assertion of additional claims. Unasserted claims are accrued on the Foundation's balance sheet, and the Hospital has been charged an allocated portion relative to its risk.

12. Hospital Revenue Bonds

Long-term debt is comprised of the following (in thousands):

	Interest Rate(s)	Final Maturity	Amount Outstanding December 31 2012	2011
City of Lakewood, Ohio Hospital Revenue Bonds:				
Series 2003	4.53% to 4.75%	2015	**$ 10,590**	$ 13,100
			10,590	13,100
Unamortized premium			**364**	535
Current portion			**(2,645)**	(2,510)
			$ 8,309	$ 11,125

In November 2003, pursuant to certain agreements between the Hospital and the City, the City issued $27.6 million of fixed rate Hospital Revenue Bonds (the Series 2003 Bonds). Proceeds from the sale of the Series 2003 Bonds were used to refund certain then-outstanding bonds, and to finance certain capital expenditures of the Hospital.

12. Hospital Revenue Bonds (continued)

Combined aggregate maturities of the bonds for the five years subsequent to December 31, 2011, are as follows (in thousands): 2013 – $2,645; 2014 – $2,785; 2015 – $5,160; 2016 – $0; and 2017 – $0.

In connection with the outstanding Hospital Revenue Bonds, the trust indenture between the City and the trust provides that the Hospital shall establish and maintain a debt service reserve fund separate and distinct from all other funds. At December 31, 2012 and 2011, funds held under the indenture for debt service reserve and debt service costs are classified as funds held by bond trustees in the balance sheets. The trust indenture also contains certain restrictive covenants, including provisions relating to maintaining certain debt ratios and other matters. The Hospital was in compliance with these covenants at December 31, 2012 and 2011.

13. Notes Payable and Capital Leases

In connection with executing the Amended Lease in 1996 with the City (Note 1), the Hospital has agreed to make additional payments to the City. The additional payments commenced in 1997 and range in annual amounts from $1.0 million to $1.2 million through 2026. Future minimum lease payments, including total interest of $5.4 million, are as follows (in thousands): 2013 – $1,125; 2014 – $1,125; 2015 – $1,150; 2016 – $1,150; 2017 – $1,150; and thereafter – $10,800.

The Hospital has the option to renew the Amended Lease for an additional term of 30 years. The net present value of the additional payments is $11.1 million and $11.6 million at December 31, 2012 and 2011, respectively (discounted at an interest rate of 6%), which is included in notes payable and capital leases, except for the current portion of $0.5 million and $0.4 million at December 31, 2012 and 2011, respectively, which is included in current portion of long-term debt.

Total interest paid on hospital revenue bonds, notes payable, and capital leases approximated $1.2 million and $1.3 million in 2012 and 2011, respectively.

14. Retirement Benefit Plans

The Hospital's employees participate in the retirement benefit plans established by the Foundation, including the CCHS Retirement Plan, a defined benefit pension plan covering substantially all employees. The benefits provided are based on age, years of service and compensation. It is the policy of the Foundation to fund at least the minimum amounts required by the Employee Retirement Income Security Act of 1974. The cost incurred on the defined benefit plan is based upon an allocation of the cost of the plan expense from the Foundation. The defined benefit plan ceased benefit accruals as of December 31, 2009 for substantially all employees. Retirement Plan ceased benefit accruals as of December 31, 2009 for substantially all employees. Benefit accruals for remaining employees ceased at various intervals through December 31, 2012.

The Hospital implemented a new noncontributory, defined contribution plan effective January 1, 2010, which covers substantially all of the Hospital's employees. The Hospital's contribution for the plan is based upon a percentage of employee compensation and years of service. The Hospital also sponsors an additional noncontributory, defined contribution plan, which covers certain of its employees. The Hospital's contribution to the plan is based upon a percentage of employee compensation, as defined, determined according to age. The Hospital also sponsors a contributory, defined contribution plan, which covers substantially all employees. The Hospital's contributions to the contributory plan, if required, are determined based on employee contributions.

Included in the Hospital's salaries, wages and benefits is retirement benefit expense pertaining to the defined contribution plans of approximately $3.0 million and $3.5 million in 2012 and 2011, respectively.

15. Commitments and Contingencies

The Hospital leases various equipment and facilities under operating lease arrangements. Total rental expense was $1.5 million and $1.6 million in 2012 and 2011, respectively. Minimum future operating lease payments are as follows (in thousands): 2013 – $893; 2014 – $841; 2015 – $856; 2016 – $862; 2017 – $821; and thereafter – $349.

At December 31, 2012, the Hospital has commitments for construction and other related contracts of $0.5 million.

16. Related-Party Transactions

The Hospital contracts with the Foundation and its affiliates for certain services in the normal course of business. Expenses include $24.6 million in both 2012 and 2011 for these services.

17. Functional Expenses

The Hospital's functional expenses are as follows (in thousands):

	2012	2011
Health care services	**$ 117,180**	$ 118,431
Research	**7**	11
General and administrative	**21,309**	20,905
	$ 138,496	$ 139,347

18. Subsequent Events

The Hospital evaluated events and transactions occurring subsequent to December 31, 2012 through May 29, 2013, the date the financial statements were issued. During this period, there were no nonrecognized subsequent events requiring recognition or disclosure in the financial statements.

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