AUDITED FINANCIAL STATEMENTS

Lakewood Hospital Association
December 31, 2009 and 2008
With Report of Independent Auditors

Ernst & Young LLP

Lakewood Hospital Association

Audited Financial Statements

December 31, 2009 and 2008

Contents

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Report of Independent Auditors

The Board of Trustees
Lakewood Hospital Association

We have audited the accompanying balance sheets of Lakewood Hospital Association d.b.a. Lakewood Hospital (the Hospital) as of December 31, 2009 and 2008, and the related statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We 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 Hospital's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hospital at December 31, 2009 and 2008, and the results of its operations and changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 3 to the financial statements, in 2009 the Hospital changed the threshold for capitalizing fixed assets.

Ernst & Young LLP

May 7, 2010

Lakewood Hospital Association

Balance Sheets
(In Thousands)

	December 31 2009	December 31 2008
Assets		
Current assets:		
Cash and cash equivalents	**$ 2,792**	$ 5,436
Patient receivables, net of allowances for uncollectible accounts of $3,893 in 2009 and $2,643 in 2008	**16,844**	18,340
Other current assets	**4,571**	3,734
Total current assets	**24,207**	27,510
Investments:		
Long-term investments	**62,918**	58,811
Funds held by bond trustees	**3,188**	3,193
Donor restricted assets	**2,300**	2,718
	68,406	64,722
Property, plant, and equipment, net	**47,595**	47,808
Interest in Lakewood Hospital Foundation, Inc.	**20,191**	16,711
Other assets:		
Pledges receivable, net	**3,174**	3,596
Other noncurrent assets	**1,594**	6,073
	4,768	9,669
Total assets	**$ 165,167**	$ 166,420

	December 31	
	2009	**2008**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 5,186**	$ 6,926
Compensation and amounts withheld from payroll	**4,893**	4,884
Estimated amounts due to third-party payors	**720**	637
Current portion of long-term debt	**3,296**	2,563
Variable rate debt classified as current	**–**	590
Other current liabilities	**2,219**	2,387
Total current liabilities	**16,314**	17,987
Long-term debt:		
Hospital revenue bonds	**16,352**	18,772
Notes payable and capital leases	**12,263**	12,721
	28,615	31,493
Other liabilities	**184**	196
Net assets:		
Unrestricted	**92,433**	92,360
Temporarily restricted	**16,069**	13,530
Permanently restricted	**11,552**	10,854
Total net assets	**120,054**	116,744
Total liabilities and net assets	**$ 165,167**	$ 166,420

See accompanying notes.

Lakewood Hospital Association

Statements of Operations and Changes in Net Assets

(In Thousands)

	Year Ended December 31	
	2009	**2008**
Unrestricted revenues		
Net patient service revenue	**$ 135,186**	$ 140,654
Other	**7,747**	7,582
Total unrestricted revenues	**142,933**	148,236
Expenses		
Salaries, wages, and benefits	**81,227**	80,237
Supplies	**14,985**	15,279
Pharmaceuticals	**5,083**	5,266
Purchased services	**7,376**	6,571
Administrative services	**15,083**	14,864
Facilities	**9,661**	9,960
Insurance	**2,274**	2,160
Provision for uncollectible accounts	**8,626**	8,305
	144,315	142,642
Operating (loss) income before interest, depreciation and amortization expenses	**(1,382)**	5,594
Interest	**1,512**	1,813
Depreciation and amortization	**6,756**	6,748
Operating loss	**(9,650)**	(2,967)
Nonoperating gains and losses		
Investment return (loss)	**9,093**	(23,614)
Other, net	**(51)**	(58)
Net nonoperating gains and losses	**9,042**	(23,672)
Deficiency of revenues over expenses	**(608)**	(26,639)

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 as previously reported at January 1, 2008	$ 120,432	$ 16,881	$ 12,762	$ 150,075
Retrospective application of change in accounting principle for property, plant and equipment	(1,519)	–	–	(1,519)
Balances as adjusted at January 1, 2008	118,913	16,881	12,762	148,556
Deficiency of revenues over expenses	(26,639)	–	–	(26,639)
Net assets released from restrictions for capital	86	(86)	–	–
Gifts and bequests	–	4,964	–	4,964
Net investment loss	–	(650)	–	(650)
Net assets released from restrictions used for operations included in other unrestricted revenues	–	(1)	–	(1)
Change in interest in Lakewood Hospital Foundation	–	(7,578)	(1,809)	(9,387)
Change in value of perpetual trusts	–	–	(99)	(99)
Decrease in net assets	(26,553)	(3,351)	(1,908)	(31,812)
Balances at December 31, 2008	92,360	13,530	10,854	116,744
Deficiency of revenues over expenses	**(608)**	**–**	**–**	**(608)**
Net assets released from restrictions for capital	**681**	**(681)**	**–**	**–**
Gifts and bequests	**–**	**518**	**–**	**518**
Net investment income	**–**	**251**	**–**	**251**
Net assets released from restrictions used for operations included in other unrestricted revenues	**–**	**(428)**	**–**	**(428)**
Change in interest in Lakewood Hospital Foundation	**–**	**2,879**	**601**	**3,480**
Change in value of perpetual trusts	**–**	**–**	**97**	**97**
Increase in net assets	**73**	**2,539**	**698**	**3,310**
Balances at December 31, 2009	**$ 92,433**	**$ 16,069**	**$ 11,552**	**$ 120,054**

See accompanying notes.

Lakewood Hospital Association

Statements of Cash Flows
(In Thousands)

	Year Ended December 31	
	2009	**2008**
Operating activities		
Increase (decrease) in net assets	**$ 3,310**	$ (31,812)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by (used in) operating activities:		
Change in interest in Lakewood Hospital Foundation	**(3,480)**	9,387
Loss on extinguishment of debt	**–**	8
Net (increase) decrease in investments classified as trading	**(3,689)**	4,434
Income from equity investee	**(947)**	(1,000)
Depreciation and amortization	**6,756**	6,748
Provision for uncollectible accounts	**8,626**	8,305
Restricted gifts, bequests and investment income	**(769)**	(4,314)
Change in value of perpetual trusts	**(97)**	99
Amortization of bond premium	**(172)**	(162)
Changes in operating assets and liabilities:		
Patient receivables	**(7,130)**	(6,199)
Other assets	**(319)**	1,078
Accounts payable and other current liabilities	**(1,808)**	(4,582)
Other liabilities	**(12)**	153
Net cash provided by (used in) operating activities	**269**	(17,857)
Financing activities		
Payments to purchase bonds in lieu of redemption	**–**	(3,160)
Principal payments on long-term debt	**(2,565)**	(2,410)
Change in pledges receivable	**(78)**	(4,596)
Restricted gifts, bequests and investment income	**769**	4,314
Net cash used in financing activities	**(1,874)**	(5,852)
Investing activities		
Expenditures for property and equipment, net	**(6,544)**	(4,198)
Decrease in nontrading investments, net	**5**	395
Distribution from equity investee	**5,500**	–
Net cash used in investing activities	**(1,039)**	(3,803)
Decrease in cash and cash equivalents	**(2,644)**	(27,512)
Cash and cash equivalents at beginning of year	**5,436**	32,948
Cash and cash equivalents at end of year	**$ 2,792**	$ 5,436

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, Level II trauma center, 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 11). The real and personal property are included in the Hospital's balance sheets as of December 31, 2009 and 2008. 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 12).

2. Affiliations

Lakewood Hospital Foundation (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.

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 $0.7 million and $5.2 million at December 31, 2009 and 2008, 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 $1.0 million in both 2009 and 2008 in other unrestricted revenue. The Hospital received a $5.5 million distribution from WIC in 2009.

3. Accounting Policies

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 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.

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. An estimated allowance is recorded which results in patient receivables being reported at the net amount expected to be received from third-party payors.

3. Accounting Policies (continued)

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. Medicare payments for capital are received on a prospective basis and on 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 fiscal intermediary. 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 revenue of $0.1 million and an increase in net patient revenue of $6.5 million in 2009 and 2008, respectively, related to changes in estimates.

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. 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.

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 31%, 7%, and 9% at December 31, 2009 and 32%, 9%, and 9% at December 31, 2008, respectively, of the Hospital's total patient receivables. Revenues from the Medicare and Medicaid programs and one commercial payor accounted for approximately 45%, 7%, and 14%, respectively, in 2009, and 50%, 7%, and 14%, respectively, in 2008 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.

3. Accounting Policies (continued)

The provision 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 coverages 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.

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 services for which patients have the obligation and willingness to pay but do not have the ability to do so. Charity care provided in 2009 and 2008, measured at established rates, approximated $26.0 million and $23.8 million, respectively, and is not included in net patient service revenue.

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 0.5% and 2.2% in 2009 and 2008, respectively. The Hospital's share of the STIP is $2.7 million and $5.4 million at December 31, 2009 and 2008, respectively.

Inventories

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

3. Accounting Policies (continued)

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. 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 are assigned a useful life of up 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.

In 2009, the Hospital increased the threshold for capitalizing fixed assets to better align the capital policy with industry and government standards. The accounting change has been applied through a retrospective change in accounting principle that reduced unrestricted net assets by $1.5 million at January 1, 2008, representing the net book value of those assets purchased prior to 2008 with an original cost basis below the new capitalization threshold. The accounting change also reduced previously reported depreciation expense for 2008 by $317,000.

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 $212,000 and $253,000 at December 31, 2009 and 2008, respectively.

Other Current and Noncurrent Liabilities

Other current liabilities include patient account credit balances, accrued interest payable, state franchise fee liability, and current portion of accrued self-insured workers' compensation claims.

Other noncurrent liabilities, net of current portion, consist of accrued self-insured workers' compensation claims and amounts due to third-party payors.

3. Accounting Policies (continued)

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheets and are classified as trading excluding funds held by bond trustees which are classified as nontrading. 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 7).

Return on investments, including equity method income (loss) 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, including realized and unrealized gains and losses, is included in temporarily restricted net assets.

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

3. Accounting Policies (continued)

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.

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 promises 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, 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.

Deficiency of Revenues Over Expenses

The statements of operations and changes in net assets include deficiency of revenues over expenses. Changes in unrestricted net assets, which are excluded from deficiency 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).

3. Accounting Policies (continued)

Recent Accounting Pronouncements

In May 2009 and as clarified in March 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance on subsequent event accounting that defines subsequent events as events or transactions that occur after the balance sheet date, but before the financial statements are issued or available to be issued. It defines two types of subsequent events: recognized subsequent events, which provide additional evidence about conditions that existed at the balance sheet date, and nonrecognized subsequent events, which provide evidence about conditions that did not exist as of the balance sheet date, but arose after that date. Recognized subsequent events are required to be recognized in the financial statements, and certain nonrecognized subsequent events are required to be disclosed. The guidance requires entities to disclose the date through which the subsequent events have been evaluated, and the basis for that date. The Hospital adopted the new guidance as required (Note 17). Adoption of the new guidance had no impact on the Hospital’s financial results.

In May 2009, the FASB issued authoritative guidance intended to improve the financial accounting and reporting for not-for-profit mergers and acquisitions and intangible assets. The guidance amends the accounting literature for business combinations between two or more not-for-profit entities and establishes principles and requirements for how a not-for-profit entity determines whether a combination is a merger or an acquisition, applies the carryover method in accounting for a merger, applies the acquisition method in accounting for an acquisition, including determining which of the combining entities is the acquirer, and determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of a merger or an acquisition. The guidance is effective for mergers that occur during reporting periods beginning on or after December 15, 2009 and for acquisitions that take place during fiscal years that begin on or after December 15, 2009. The Hospital will apply this guidance to any future business combinations.

In June 2009, the FASB issued the FASB Accounting Standards Codification (the Codification). The Codification became the single source of authoritative, nongovernmental US accounting and reporting standards, but it did not change accounting principles generally accepted in the United States. The statement was effective for interim and annual periods ending after September 15, 2009. The Hospital adopted the new authoritative guidance as required. Adoption of the new guidance had no impact on the Hospital’s financial results.

3. Accounting Policies (continued)

In January 2010, the FASB issued authoritative guidance regarding improving fair value disclosures. The guidance requires a number of additional disclosures regarding fair value measurements. The guidance is effective for interim and annual reporting periods beginning after December 15, 2009. The Hospital is currently evaluating the new guidance and will make additional disclosures as required upon the effective date.

4. Temporarily Restricted Net Assets

Temporarily restricted net assets are comprised of the following at December 31, 2009 and 2008, (in thousands):

	2009	2008
Pledges receivable	**$ 4,674**	$ 4,596
Plant replacement and expansion funds	**1,423**	1,295
Specific purpose funds	**877**	1,423
Interest in Lakewood Hospital Foundation, Inc.'s temporarily restricted net assets	**9,095**	6,216
	$ 16,069	$ 13,530

5. Permanently Restricted Net Assets

Permanently restricted net assets are comprised of the following at December 31, 2009 and 2008, (in thousands):

	2009	2008
Interest in Lakewood Hospital Foundation, Inc.'s permanently restricted net assets	**$ 11,096**	$ 10,495
Perpetual trust	**456**	359
	$ 11,552	$ 10,854

6. Cash, Cash Equivalents, and Investments

The composition of cash, cash equivalents, and investments at December 31, 2009 and 2008, is as follows (in thousands):

	2009	2008
Cash and cash equivalents	**$ 6,344**	$ 9,660
Cleveland Clinic Foundation Long-Term Investment Pool	**64,854**	60,498
Total cash, cash equivalents, and investments	**$ 71,198**	$ 70,158

Total investment return is comprised of the following for the years ended December 31, 2009 and 2008 (in thousands):

	2009	2008
Other revenue:		
Interest income and dividends	**$ 2**	$ 41
Nonoperating gains (losses), net:		
Interest income and dividends	**451**	1,312
Net realized losses on sales of investments	**(5,101)**	(4,567)
Net unrealized gains (losses) on investments	**13,386**	(16,065)
Equity method income (loss) on alternative investments	**357**	(4,294)
	9,093	(23,614)
Other changes in net assets:		
Net appreciation (depreciation) on restricted investments	**251**	(650)
	$ 9,346	$ (24,223)

7. Fair Value Measurements

The carrying values of cash and cash equivalents, 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. The fair value of the Hospital's pledges receivable based on discounted cash flow analysis and adjusted for consideration of the donor's credit was $4.7 million (see carrying value at Note 9) at December 31, 2009 and 2008. The fair value of the Hospital's long-term debt, as estimated by discounted cash flow analyses using current borrowing rates for similar types of borrowing arrangements and adjusted for the Hospital's credit was $19.2 million and $21.3 million (see carrying value at Note 11) at December 31, 2009 and 2008, respectively. Other noncurrent assets and liabilities have carrying values that approximate fair value.

7. Fair Value Measurements (continued)

The Hospital's share of the LTIP was $64.9 million and $60.5 million at December 31, 2009 and 2008, 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, 2009	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Investments:				
Cash and cash equivalents	**23%**	**3%**	**–%**	**26%**
Fixed income securities:				
U.S. Treasuries	**18**	**–**	**–**	**18**
U.S. government agencies	**–**	**1**	**–**	**1**
U.S. corporate	**–**	**4**	**–**	**4**
U.S. government agencies asset-backed	**–**	*****	**–**	*****
Corporate asset-backed	**–**	**1**	**–**	**1**
Common collective trusts	**–**	**9**	**–**	**9**
Foreign	**–**	**1**	**–**	**1**
Common and preferred stocks:				
U.S.	**17**	**–**	**–**	**17**
Common collective trusts	**–**	**12**	**–**	**12**
Foreign	**11**	**–**	**–**	**11**
Total investments	**69%**	**31%**	**–%**	**100%**

** Represents less than 1% of total investments.*

December 31, 2008	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Investments:				
Cash and cash equivalents	24%	14%	–%	38%
Fixed income securities:				
U.S. Treasuries	3	–	–	3
U.S. government agencies	–	2	–	2
U.S. corporate	–	4	–	4
U.S. government agencies asset-backed	–	1	–	1
Corporate asset-backed	–	1	–	1
Common collective trusts	–	9	–	9
Foreign	–	1	–	1
Common and preferred stocks:				
U.S.	32	–	–	32
Common collective trusts	–	3	–	3
Foreign	6	–	–	6
Total investments	65%	35%	–%	100%

7. 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, 2009 and 2008, based on the valuation hierarchy (in thousands):

December 31, 2009	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	**$ 6,344**	**$ –**	**$ –**	**$ 6,344**
Perpetual trust	**–**	**456**	**–**	**456**
Total	**$ 6,344**	**$ 456**	**$ –**	**$ 6,800**

December 31, 2008	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	$ 9,660	$ –	$ –	$ 9,660
Perpetual trust	–	359	–	359
Total	$ 9,660	$ 359	$ –	$ 10,019

The fair values of the securities included in Level 1 is based upon quoted market prices. Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers.

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.

8. Property, Plant, and Equipment

Property, plant, and equipment are comprised of the following at December 31, 2009 and 2008 (in thousands):

	2009	2008
Land and improvements	**$ 4,109**	$ 4,109
Buildings	**113,334**	107,949
Equipment	**41,696**	42,399
Construction-in-progress	**503**	3,500
Computer hardware and software	**10,538**	10,474
	170,180	168,431
Accumulated depreciation	**(122,585)**	(120,623)
	$ 47,595	$ 47,808

9. Pledges Receivable

Outstanding pledges receivable at December 31, 2009 and 2008, are as follows (in thousands):

	2009	2008
Pledges due:		
In less than one year	**$ 1,500**	$ 1,000
In one to five years	**3,500**	4,000
	5,000	5,000
Present value discount	**(326)**	(404)
Current portion	**(1,500)**	(1,000)
	$ 3,174	$ 3,596

10. 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.

11. Hospital Revenue Bonds

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

	Interest Rate(s)	Due Date	Amount Outstanding December 31 2009	Amount Outstanding December 31 2008
City of Lakewood, Ohio Hospital Revenue Bonds:				
Series 2003	3.87% to 4.75%	Through 2015	**$ 17,725**	$ 19,860
Series 1983	Variable rate	Through 2010	**590**	590
			18,315	20,450
Unamortized premium			**877**	1,047
Current portion			**(2,840)**	(2,135)
Long-term variable rate debt classified as other current liabilities			**–**	(590)
			$ 16,352	$ 18,772

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.

11. Hospital Revenue Bonds (continued)

The Series 1983 Bonds are to mature in 2010 with early redemption provisions available. The bonds bear interest at a floating rate established semiannually based upon prevailing interest rates at the time and are secured by a letter of credit, which expires November 1, 2010. The interest rates on the bonds at December 31, 2009 and 2008, were 0.48% and 2.80%, respectively. Under terms of the letter of credit agreement, if required, the bank will make liquidity loans to the Hospital in the amount necessary to purchase a portion of the variable rate demand revenue bonds if not remarketed. Liquidity loans are payable to the bank in less than one year, and as such, in 2008 the bonds were classified as other current liabilities in the accompanying balance sheets.

In October 2008, pursuant to provisions for purchase in lieu of redemption, the Hospital purchased $3.2 million of outstanding Series 1983 variable-rate Revenue Bonds. The transaction was accounted for as an extinguishment for accounting purposes.

Combined aggregate maturities of the bonds for the five years subsequent to December 31, 2009, are as follows (in thousands): 2010 – $2,840; 2011 – $2,375; 2012 – $2,510; 2013 – $2,645, and 2014 – $2,785.

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, 2009 and 2008, 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. At December 31, 2008 and 2009, the Hospital was not in compliance with the debt service ratio covenant requirement. Non-compliance requires corrective action but is not considered an event of default under the trust indenture. The Hospital is implementing corrective action in accordance with the provisions of the trust indenture.

12. Notes Payable and Capital Leases

The Hospital has an installment note payable outstanding at December 31, 2009 of $378,000, of which $80,000 is included in current portion of long-term debt and $298,000 is included in notes payable and capital leases. The note is due in 2014 with interest adjusted annually in June at rates equal to prime plus 0.5%. The interest rate was 3.75% and 5.50% at December 31, 2009 and 2008, respectively. Maturities of this obligation for the five years subsequent to December 31, 2009, are as follows (in thousands): 2010 – $80; 2011 – $83; 2012 – $87; 2013 – $90; and 2014 – $38.

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 $7.5 million, are as follows (in thousands): 2010 – $1,100; 2011 – $1,100; 2012 – $1,125; 2013 – $1,125; 2014 – $1,125; and thereafter – $14,250.

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 of $12.3 million and $12.7 million at December 31, 2009 and 2008, respectively (discounted at an interest rate of 6%), is included in notes payable and capital leases, except for the current portion of $0.4 million at December 31, 2009 and 2008, which is included in current portion of long-term debt.

Total interest paid on Hospital Revenue Bonds, notes payable, and capital leases approximated $1.6 million and $1.9 million in 2009 and 2008, respectively.

13. Retirement Benefit Plans

The Hospital's employees participate in the retirement benefit plans established by the Foundation, including 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.

13. Retirement Benefit Plans (continued)

The Foundation also sponsors a contributory, defined contribution plan covering substantially all employees of the Hospital and a noncontributory defined contribution plan for certain employees of the Hospital. The Hospital's contribution for the contributory plan is based on 50% of an individual employee's contributions up to a maximum of 6% of the employee's compensation. The Hospital's contribution for the noncontributory defined contribution plan is based upon a percentage of employee compensation, as defined, determined according to age. Included in the Hospital's salaries, wages and benefits is retirement benefit expense pertaining to the defined contribution plans of approximately $875,000 and $830,000 in 2009 and 2008, respectively.

14. Commitments and Contingencies

The Hospital leases various equipment and facilities under operating lease arrangements. Total rental expense in 2009 and 2008 was $1.8 million and $2.2 million, respectively. Minimum future operating lease payments are as follows (in thousands): 2010 – $933; 2011 – $868; 2012 – $793; 2013 – $547; 2014 – $483, and thereafter – $2,023.

At December 31, 2009, the Hospital has commitments for construction and other related contracts of $2.0 million.

15. Related-Party Transactions

The Hospital contracts with the Foundation and its affiliates for certain services in the normal course of business. Expenses include $16.1 million in both 2009 and 2008 for these services.

16. Functional Expenses

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

	2009	**2008**
Health care services	**$ 133,881**	$ 132,591
Research	**25**	7
General and administrative	**18,677**	18,605
	$ 152,583	$ 151,203

17. Subsequent Events

The Hospital evaluated events and transactions occurring subsequent to December 31, 2009 through May 7, 2010, the date the financial statements were issued. During this period, there were no subsequent events requiring recognition in the consolidated financial statements and there were no nonrecognized subsequent events requiring disclosure.

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