



AUDITED FINANCIAL STATEMENTS

Lakewood Hospital Association  
Years Ended December 31, 2011 and 2010  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Lakewood Hospital Association

Audited Financial Statements

Years Ended December 31, 2011 and 2010

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## Report of Independent Auditors

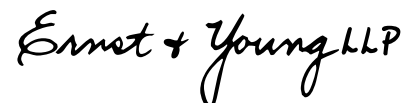
The Board of Trustees  
Lakewood Hospital Association

We have audited the accompanying balance sheets of Lakewood Hospital Association d.b.a. Lakewood Hospital (the Hospital) as of December 31, 2011 and 2010, 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, 2011 and 2010, 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, the Hospital changed its presentation of the provision for uncollectible accounts as a result of the adoption of Accounting Standards Update 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, effective January 1, 2010.



May 18, 2012

# Lakewood Hospital Association

## Balance Sheets

*(In Thousands)*

	<b>December 31</b>	
	<b>2011</b>	<b>2010</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,612	\$ 584
Patient receivables, net of allowances for uncollectible accounts of \$4,291 in 2011 and \$4,774 in 2010	12,649	13,518
Other current assets	10,190	5,366
Total current assets	26,451	19,468
Investments:		
Long-term investments	46,008	53,843
Funds held by bond trustees	3,179	3,179
Donor restricted assets	2,903	2,701
	52,090	59,723
Property, plant, and equipment, net	49,767	52,063
Interest in Lakewood Hospital Foundation, Inc.	25,844	23,496
Other assets:		
Pledges receivable, net	1,193	2,170
Other noncurrent assets	1,319	1,235
	2,512	3,405
Total assets	\$ 156,664	\$ 158,155

	<b>December 31</b>	
	<b>2011</b>	<b>2010</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 4,616	\$ 6,414
Compensation and amounts withheld from payroll	4,820	4,754
Estimated amounts due to third-party payors	538	660
Current portion of long-term debt	2,959	2,854
Other current liabilities	1,879	1,620
Total current liabilities	<u>14,812</u>	<u>16,302</u>
Long-term debt:		
Hospital revenue bonds	11,125	13,806
Notes payable and capital leases	11,117	11,784
	<u>22,242</u>	<u>25,590</u>
Other liabilities	252	183
Net assets:		
Unrestricted	86,756	86,007
Temporarily restricted	17,230	16,820
Permanently restricted	15,372	13,253
Total net assets	<u>119,358</u>	<u>116,080</u>
Total liabilities and net assets	<u><u>\$ 156,664</u></u> <u><u>\$ 158,155</u></u>	

*See accompanying notes.*

# Lakewood Hospital Association

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

	<b>Year Ended December 31</b>	
	<b>2011</b>	<b>2010</b>
<b>Unrestricted revenues</b>		
Net patient service revenue	\$ 144,778	\$ 137,269
Provision for uncollectible accounts	(15,522)	(16,306)
Net patient service revenue less provision for uncollectible accounts	129,256	120,963
Other	9,358	6,885
Total unrestricted revenues	138,614	127,848
<b>Expenses</b>		
Salaries, wages, and benefits	70,437	73,899
Supplies	15,880	16,314
Pharmaceuticals	4,092	4,273
Purchased services	6,204	7,103
Administrative services	23,810	20,727
Facilities	9,408	9,923
Insurance	1,396	2,263
	131,227	134,502
Operating income (loss) before interest, depreciation, and amortization expenses	7,387	(6,654)
Interest	1,259	1,495
Depreciation and amortization	6,861	6,858
Operating loss	(733)	(15,007)
<b>Nonoperating gains and losses</b>		
Investment return	1,170	6,989
Other, net	(55)	45
Net nonoperating gains and losses	1,115	7,034
Excess (deficiency) of revenues over expenses	382	(7,973)

*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, 2009	\$ 92,433	\$ 16,069	\$ 11,552	\$ 120,054
Deficiency of revenues over expenses	(7,973)	-	-	(7,973)
Net assets released from restrictions for capital	1,547	(1,547)	-	-
Gifts and bequests	-	647	-	647
Net investment income	-	366	-	366
Net assets released from restrictions used for operations included in other unrestricted revenues	-	(335)	-	(335)
Change in interest in Lakewood Hospital Foundation, Inc.	-	1,620	1,685	3,305
Change in value of perpetual trusts	-	-	16	16
(Decrease) increase in net assets	<u>(6,426)</u>	<u>751</u>	<u>1,701</u>	<u>(3,974)</u>
Balances at December 31, 2010	86,007	16,820	13,253	116,080
Excess of revenues over expenses	<b>382</b>	-	-	<b>382</b>
Net assets released from restrictions for capital	<b>367</b>	<b>(367)</b>	-	-
Gifts and bequests	-	<b>742</b>	-	<b>742</b>
Net investment income	-	<b>159</b>	-	<b>159</b>
Net assets released from restrictions used for operations included in other unrestricted revenues	-	<b>(394)</b>	-	<b>(394)</b>
Change in interest in Lakewood Hospital Foundation, Inc.	-	<b>270</b>	<b>2,078</b>	<b>2,348</b>
Change in value of perpetual trusts	-	-	<b>41</b>	<b>41</b>
Increase in net assets	<u><b>749</b></u>	<u><b>410</b></u>	<u><b>2,119</b></u>	<u><b>3,278</b></u>
Balances at December 31, 2011	<u><b>\$ 86,756</b></u>	<u><b>\$ 17,230</b></u>	<u><b>\$ 15,372</b></u>	<u><b>\$ 119,358</b></u>

See accompanying notes.

# Lakewood Hospital Association

## Statements of Cash Flows

*(In Thousands)*

	<b>Year Ended December 31</b>	
	<b>2011</b>	<b>2010</b>
<b>Operating activities</b>		
Increase (decrease) in net assets	\$ 3,278	\$ (3,974)
Adjustments to reconcile decrease in net assets to net cash provided by (used in) operating activities:		
Change in interest in Lakewood Hospital Foundation, Inc.	(2,348)	(3,305)
Net realized and unrealized gains on investments	(456)	(6,462)
Income from equity investee	(763)	(790)
Depreciation and amortization	6,861	6,858
Provision for uncollectible accounts	15,522	16,306
Restricted gifts, bequests, and investment income	(901)	(1,013)
Change in value of perpetual trusts	(41)	(16)
Amortization of bond premium	(171)	(171)
Changes in operating assets and liabilities:		
Patient receivables	(14,653)	(12,980)
Other assets	(4,109)	364
Accounts payable and other current liabilities	(636)	(380)
Other liabilities	69	(1)
Net cash provided by (used in) operating activities	<b>1,652</b>	<b>(5,564)</b>
<b>Financing activities</b>		
Principal payments on long-term debt	(3,072)	(3,296)
Change in pledges receivable	977	1,004
Restricted gifts, bequests, and investment income	901	1,013
Net cash used in financing activities	<b>(1,194)</b>	<b>(1,279)</b>
<b>Investing activities</b>		
Expenditures for property and equipment	(5,519)	(10,510)
Net change in cash equivalents reported in long-term investments	(170)	(161)
Purchases of investments	(741)	(694)
Sales of investments	9,000	16,000
Net cash provided by investing activities	<b>2,570</b>	<b>4,635</b>
Increase (decrease) in cash and cash equivalents	<b>3,028</b>	<b>(2,208)</b>
Cash and cash equivalents at beginning of year	<b>584</b>	<b>2,792</b>
Cash and cash equivalents at end of year	<b>\$ 3,612</b>	<b>\$ 584</b>

*See accompanying notes.*



# Lakewood Hospital Association

## Notes to Financial Statements

December 31, 2011 and 2010

### **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, 2011 and 2010. 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.

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### **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 \$0.5 million and \$0.4 million at December 31, 2011 and 2010, 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 \$0.8 million and \$0.7 million in 2011 and 2010, respectively, in other unrestricted revenue. The Hospital received distributions of \$0.7 million and \$1.0 million from WIC in 2011 and 2010, respectively, representing the Hospital's return on the investment.

### **3. Accounting Policies**

#### **Recent Accounting Pronouncements**

In August 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2010-23 related to the measurement basis used in the disclosure of charity care. The standard requires that cost be used as the measurement basis for charity care disclosure, and the disclosure should include the direct and indirect costs of providing charity care. The standard also requires disclosure of the method used to identify or determine such costs. The standard became effective for fiscal years beginning after December 15, 2010, and should be applied retrospectively. The Hospital adopted the provisions of this standard on January 1, 2011, and retrospectively applied the provisions to all periods presented. The adoption had no impact on previously reported excess of revenues over expenses or net assets.

In July 2011, the FASB issued ASU 2011-07 related to the presentation and disclosure of patient service revenue, provision for bad debts, and the allowance for uncollectible accounts. The standard requires healthcare entities that recognize significant amounts of patient service revenue at the time services are rendered, even though they do not assess the patient's ability to pay, to change the presentation of their statement of operations and changes in net assets by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue. Additionally, those healthcare entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. The standard also requires disclosures of patient service revenue by major payor source as well as qualitative and quantitative information about changes in the allowance for uncollectible accounts. The standard is effective for fiscal years and interim periods beginning after December 31, 2011, with early adoption permitted. The amendments to

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### **3. Accounting Policies (continued)**

the presentation of the provision for bad debts related to patient service revenue in the statement of operations and changes in net assets are required to be applied retrospectively to all prior periods presented. The enhanced disclosures are required to be provided in the period of adoption and subsequent reporting periods. The Hospital early adopted the provisions of this standard as of and for the year ended December 31, 2011, and retrospectively applied the presentation requirements to all periods presented. The change in presentation and additional disclosures are reflected in the Hospital's statement of operations and changes in net assets and in Note 4. Adoption of the new guidance had no impact on previously reported excess of revenues over expenses or net assets.

In May 2011, the FASB issued 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 and International Financial Reporting Standards. The new amendments clarify the Board'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 will become effective for the Hospital for annual reporting periods beginning after December 15, 2011. The Hospital is currently evaluating the new guidance and will adopt the provisions as required upon the effective date.

### **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.

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### **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 an increase in net patient service revenue of \$1.6 million and \$0.3 million in 2011 and 2010, 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.

## Lakewood Hospital Association

### Notes to Financial Statements (continued)

#### **3. Accounting Policies (continued)**

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**

The Centers for Medicare & Medicaid Services (CMS) have 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 Medicaid for the fiscal year ended September 30, 2011. The Hospital met the meaningful use objectives for Medicare and Medicaid for the federal fiscal year ending September 30, 2012. Therefore, for the year ended December 31, 2011, the Hospital has accrued EHR revenues for the incentive reporting period related to the federal fiscal year ending September 30, 2012. 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 \$2.1 million and \$0.4 million, respectively, at December 31, 2011.

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### **3. Accounting Policies (continued)**

#### **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 2011 and 2010 approximated \$6.8 million and \$8.3 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 net HCAP revenues of \$1.5 million and \$1.6 million for the years ended December 31, 2011 and 2010, respectively, which is included in net patient service revenue in the accompanying statements of operations and changes in net assets.

#### **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% and 0.2% in 2011 and 2010, respectively. The Hospital's share of the STIP is \$3.6 million and \$0.6 million at December 31, 2011 and 2010, 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 included in other current assets.

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### **3. Accounting Policies (continued)**

#### **Other Current Assets**

Other current assets consist primarily of inventories, prepaid expenses, pledge receivables, 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 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.

#### **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 \$129,000 and \$170,000 at December 31, 2011 and 2010, 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.

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### **3. Accounting Policies (continued)**

#### **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.

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.



# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### 3. Accounting Policies (continued)

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.

### 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.

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### 3. Accounting Policies (continued)

#### 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 (Deficiency) of Revenues Over Expenses

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

#### Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation, which had no impact on previously reported excess of revenues over expenses or net 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, 2011 and 2010, are as follows (in thousands):

	2011		2010	
Medicare	\$ 59,707	41%	\$ 58,265	42%
Medicaid	10,586	7	10,478	8
Managed care and commercial	52,975	37	50,811	37
Self-pay	21,510	15	17,715	13
	<u>\$ 144,778</u>	<u>100%</u>	<u>\$ 137,269</u>	<u>100%</u>

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### 4. Net Patient Service Revenue and Patient Receivables (continued)

For 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 decreased from 69% at December 31, 2010 to 67% at December 31, 2011. Self-pay write-offs decreased \$0.6 million in 2011 compared to 2010. 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 39%, 8%, and 9% at December 31, 2011 and 37%, 8%, and 10% at December 31, 2010, respectively, of the Hospital's total patient receivables. Revenues from the Medicare and Medicaid programs and one commercial payor accounted for approximately 41%, 7%, and 17%, respectively, in 2011, and 42%, 8%, and 15%, respectively, in 2010 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, 2011 and 2010, (in thousands):

	<u>2011</u>	<u>2010</u>
Pledges receivable	\$ 3,341	\$ 3,403
Plant replacement and expansion funds	1,587	1,568
Specific-purpose funds	1,317	1,134
Interest in Lakewood Hospital Foundation, Inc.'s temporarily restricted net assets	<u>10,985</u>	<u>10,715</u>
	<u>\$ 17,230</u>	<u>\$ 16,820</u>

## Lakewood Hospital Association

### Notes to Financial Statements (continued)

#### 6. Permanently Restricted Net Assets

Permanently restricted net assets are comprised of the following at December 31, 2011 and 2010, (in thousands):

	<b>2011</b>	<b>2010</b>
Interest in Lakewood Hospital Foundation, Inc.'s permanently restricted net assets	<b>\$ 14,859</b>	<b>\$ 12,781</b>
Perpetual trust	<b>513</b>	<b>472</b>
	<b>\$ 15,372</b>	<b>\$ 13,253</b>

#### 7. Cash, Cash Equivalents, and Investments

The composition of cash, cash equivalents, and investments at December 31, 2011 and 2010, is as follows (in thousands):

	<b>2011</b>	<b>2010</b>
Cash and cash equivalents	<b>\$ 7,494</b>	<b>\$ 4,297</b>
Cleveland Clinic Foundation Long-Term Investment Pool	<b>48,208</b>	<b>56,010</b>
Total cash, cash equivalents, and investments	<b>\$ 55,702</b>	<b>\$ 60,307</b>

Total investment return, including LTIP earnings allocated to the Hospital, is comprised of the following for the years ended December 31, 2011 and 2010 (in thousands):

	<b>2011</b>	<b>2010</b>
Other revenue:		
Interest income and dividends	<b>\$ -</b>	<b>\$ 8</b>
Nonoperating gains, net:		
Interest income and dividends	<b>716</b>	<b>737</b>
Net realized gains on sales of investments	<b>1,121</b>	<b>1,181</b>
Net change in unrealized (losses) gains on investments	<b>(985)</b>	<b>3,500</b>
Equity method income on alternative investments	<b>318</b>	<b>1,571</b>
	<b>1,170</b>	<b>6,989</b>
Other changes in net assets:		
Investment income on restricted investments	<b>159</b>	<b>366</b>
	<b>\$ 1,329</b>	<b>\$ 7,363</b>

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### 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. 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 \$3.4 million (see carrying value at Note 10) at both December 31, 2011 and 2010. 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 \$13.6 million and \$16.2 million (see carrying value at Note 12) at December 31, 2011 and 2010, respectively. Other noncurrent assets and liabilities have carrying values that approximate fair value.

The Hospital's share of the LTIP was \$48.2 million and \$56.0 million at December 31, 2011 and 2010, 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:

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

# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### 8. Fair Value Measurements (continued)

<b>December 31, 2010</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Investments:				
Cash and cash equivalents	5%	<1%	–%	5%
Fixed income securities:				
U.S. treasuries	25	–	–	25
U.S. government agencies	–	<1	–	<1
U.S. corporate	–	8	–	8
U.S. government agencies asset-backed	–	<1	–	<1
Foreign	–	1	–	1
Commingled fixed income funds	–	16	–	16
Common and preferred stocks:				
U.S.	20	<1	–	20
Foreign	11	–	–	11
Commingled equity funds	–	14	–	14
<b>Total investments</b>	<b>61%</b>	<b>39%</b>	<b>–%</b>	<b>100%</b>

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, 2011 and 2010, based on the valuation hierarchy (in thousands):

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

<b>December 31, 2010</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets:</b>				
Cash and cash equivalents	\$ 4,297	\$ –	\$ –	\$ 4,297
Perpetual trust	–	472	–	472
<b>Total</b>	<b>\$ 4,297</b>	<b>\$ 472</b>	<b>\$ –</b>	<b>\$ 4,769</b>

See Note 7 for the location of cash and cash equivalents on the balance sheets. The Hospital's perpetual trust is reported in other noncurrent assets on the balance sheets. Other noncurrent assets include \$0.8 million at both December 31, 2011 and 2010, of assets that are not measured at fair value on a recurring basis.

## Lakewood Hospital Association

### Notes to Financial Statements (continued)

#### 8. Fair Value Measurements (continued)

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 investments 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 3.9% and 4.1% at December 31, 2011 and 2010, respectively, which is based on Treasury yield curve rates.

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, 2011 and 2010 (in thousands):

	<u>2011</u>	<u>2010</u>
Land and improvements	\$ 4,109	\$ 4,109
Buildings	124,761	119,093
Equipment	45,389	42,992
Construction-in-progress	390	4,152
Computer hardware and software	10,537	10,443
	<u>185,186</u>	<u>180,789</u>
Accumulated depreciation	(135,419)	(128,726)
	<u>\$ 49,767</u>	<u>\$ 52,063</u>

## Lakewood Hospital Association

### Notes to Financial Statements (continued)

#### 10. Pledges Receivable

Outstanding pledges receivable at December 31, 2011 and 2010, are as follows (in thousands):

	<b>2011</b>	<b>2010</b>
Pledges due:		
In less than one year	\$ 2,250	\$ 1,233
In one to five years	<b>1,353</b>	2,366
	<b>3,603</b>	3,599
Present value discount	<b>(99)</b>	(196)
Allowance for uncollectible pledges	<b>(163)</b>	-
Current portion (net of allowance for uncollectible pledges)	<b>(2,148)</b>	(1,233)
	<b>\$ 1,193</b>	\$ 2,170

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.

#### 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.



# Lakewood Hospital Association

## Notes to Financial Statements (continued)

### 12. Hospital Revenue Bonds

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

	Interest Rate(s)	Final Maturity	Amount Outstanding December 31	
			2011	2010
City of Lakewood, Ohio Hospital Revenue Bonds: Series 2003	4.40% to 4.75%	2015	<b>\$ 13,100</b>	\$ 15,475
			<b>13,100</b>	15,475
Unamortized premium			535	706
Current portion			<b>(2,510)</b>	(2,375)
			<b>\$ 11,125</b>	\$ 13,806

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.

Combined aggregate maturities of the bonds for the five years subsequent to December 31, 2011, are as follows (in thousands): 2012 – \$2,510; 2013 – \$2,645; 2014 – \$2,785; 2015 – \$5,160; and 2016 – \$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, 2011 and 2010, 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, 2011, the Hospital was in compliance with the debt service ratio covenant requirement. At December 31, 2010, the Hospital was not in compliance with the debt service coverage ratio requirement. Noncompliance required corrective action but was not considered an event of default under the trust indenture.

## Lakewood Hospital Association

### Notes to Financial Statements (continued)

#### **13. Notes Payable and Capital Leases**

The Hospital had an installment note payable outstanding at December 31, 2010 of \$298,000, of which \$80,000 was included in current portion of long-term debt and \$218,000 was included in notes payable and capital leases. The Hospital paid the entire outstanding balance of the note in 2011.

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 \$6.1 million, are as follows (in thousands): 2012 – \$1,125; 2013 – \$1,125; 2014 – \$1,125; 2015 – \$1,150; 2016 – \$1,150; and thereafter – \$11,950.

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 \$11.6 million and \$12.0 million at December 31, 2011 and 2010, respectively (discounted at an interest rate of 6%), which is included in notes payable and capital leases, except for the current portion of \$0.4 million at December 31, 2011 and 2010, which is included in current portion of long-term debt.

Total interest paid on Hospital Revenue Bonds, notes payable, and capital leases approximated \$1.3 million and \$1.5 million in 2011 and 2010, 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.

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.

## Lakewood Hospital Association

### Notes to Financial Statements (continued)

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

The Hospital 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 \$3.5 million in both 2011 and 2010.

#### 15. Commitments and Contingencies

The Hospital leases various equipment and facilities under operating lease arrangements. Total rental expense was \$1.6 million and \$1.9 million in 2011 and 2010, respectively. Minimum future operating lease payments are as follows (in thousands): 2012 – \$1,376; 2013 – \$1,316; 2014 – \$1,264; 2015 – \$1,279; 2016 – \$1,286; and thereafter – \$2,282.

At December 31, 2011, the Hospital has commitments for construction and other related contracts of \$0.3 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 and \$20.9 million in 2011 and 2010, respectively, for these services.

#### 17. Functional Expenses

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

	<u>2011</u>	<u>2010</u>
Health care services	\$ 118,431	\$ 123,688
Research	11	11
General and administrative	20,905	19,355
	<u>\$ 139,347</u>	<u>\$ 143,054</u>

## Lakewood Hospital Association

### Notes to Financial Statements (continued)

#### **18. Subsequent Events**

The Hospital evaluated events and transactions occurring subsequent to December 31, 2011 through May 18, 2012, 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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