



RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Financial Statements

September 30, 2009 and 2008

(With Independent Auditors' Report Thereon)

RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Financial Statements

September 30, 2009 and 2008

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KPMG LLP
50 Kennedy Plaza
Providence, RI 02903

Independent Auditors' Report

The Board of Trustees
Rhode Island Hospital:

We have audited the accompanying consolidated statements of financial position of Rhode Island Hospital and Affiliates (the Hospital) as of September 30, 2009 and 2008, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Rhode Island Hospital and Affiliates as of September 30, 2009 and 2008, and the results of their operations and changes in net assets, and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As described in note 3 to the consolidated financial statements, in 2009 the Hospital adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 820-10, *Fair Value Measurements and Disclosures*, and ASC Subtopic 958-250, *Classification of Donor-Restricted Endowment Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act*.

KPMG LLP

February 19, 2010

RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Statements of Financial Position

September 30, 2009 and 2008

(In thousands)

| Assets | 2009 | 2008 | Liabilities and Net Assets | 2009 | 2008 |
|--|---------------------|---------------------|---|---------------------|---------------------|
| Current assets: | | | Current liabilities: | | |
| Cash and cash equivalents | \$ 81,927 | \$ 34,337 | Accounts payable | \$ 32,489 | \$ 31,988 |
| Patient accounts receivable | 147,910 | 137,936 | Accrued employee benefits and compensation | 39,579 | 27,955 |
| Less allowance for doubtful accounts | <u>(31,301)</u> | <u>(32,112)</u> | Other accrued expenses | 12,723 | 18,533 |
| Net patient accounts receivable | 116,609 | 105,824 | Current portion of long-term debt | 6,851 | 3,371 |
| Other receivables | <u>8,469</u> | <u>11,272</u> | Current portion of estimated third-party payor settlements | 21,112 | 12,236 |
| | | | Estimated health care benefit self-insurance costs | <u>4,478</u> | <u>3,258</u> |
| Total receivables | 125,078 | 117,096 | Total current liabilities | 117,232 | 97,341 |
| Assets limited as to use | 2 | 847 | Long-term debt, net of current portion | 271,108 | 205,922 |
| Inventories | 11,470 | 10,701 | Estimated third-party payor settlements, net of current portion | 44,327 | 45,387 |
| Prepaid expenses and other current assets | <u>1,901</u> | <u>1,842</u> | Accrued pension liability | 97,513 | 35,000 |
| | | | Other liabilities | <u>23,397</u> | <u>24,439</u> |
| Total current assets | 220,378 | 164,823 | Total liabilities | 553,577 | 408,089 |
| Interest in net assets of Rhode Island Hospital Foundation | 42,552 | 49,811 | Net assets: | | |
| Assets limited as to use | 449,164 | 419,012 | Unrestricted | 394,666 | 434,831 |
| Less amount required to meet current obligations | <u>(2)</u> | <u>(847)</u> | Temporarily restricted | 207,378 | 120,429 |
| Noncurrent assets limited as to use | 449,162 | 418,165 | Permanently restricted | <u>57,014</u> | <u>158,926</u> |
| Property and equipment, net | 489,295 | 479,148 | Total net assets | 659,058 | 714,186 |
| Other assets: | | | | | |
| Deferred charges and financing costs, net | 7,412 | 5,628 | | | |
| Other noncurrent assets | <u>3,836</u> | <u>4,700</u> | | | |
| Total other assets | <u>11,248</u> | <u>10,328</u> | | | |
| Total assets | \$ <u>1,212,635</u> | \$ <u>1,122,275</u> | Total liabilities and net assets | \$ <u>1,212,635</u> | \$ <u>1,122,275</u> |

See accompanying notes to consolidated financial statements.

RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2009 and 2008

(In thousands)

| | 2009 | 2008 |
|---|------------|------------|
| Unrestricted revenues and other support: | | |
| Net patient service revenue | \$ 881,533 | \$ 840,004 |
| Other revenue | 34,771 | 37,709 |
| Endowment earnings contributed toward community benefit | 6,570 | 6,895 |
| Net assets released from restrictions used for operations | 15,816 | 15,665 |
| Net assets released from restrictions used for research | 45,023 | 49,369 |
| Total unrestricted revenues and other support | 983,713 | 949,642 |
| Operating expenses: | | |
| Compensation and benefits | 519,049 | 490,708 |
| Supplies and other expenses | 198,259 | 198,664 |
| Purchased services | 109,824 | 112,428 |
| Provision for bad debts | 51,126 | 56,538 |
| Depreciation and amortization | 32,698 | 31,024 |
| Interest | 12,094 | 9,707 |
| License fees | 40,868 | 24,408 |
| Total operating expenses | 963,918 | 923,477 |
| Income from operations | 19,795 | 26,165 |
| Nonoperating gains and losses: | | |
| Net realized (losses) gains on board-designated investments | (8,902) | 1,438 |
| Other nonoperating (losses) gains, net | (85) | 113 |
| Total nonoperating (losses) gains, net | (8,987) | 1,551 |
| Excess of revenues over expenses | \$ 10,808 | \$ 27,716 |

RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets (Continued)

Years ended September 30, 2009 and 2008

(In thousands)

| | 2009 | 2008 |
|--|------------|------------|
| Unrestricted net assets: | | |
| Excess of revenues over expenses | \$ 10,808 | \$ 27,716 |
| Other changes in unrestricted net assets: | | |
| Change in funded status of pension and other postretirement plans, other than net periodic pension and postretirement benefit costs | (57,439) | (4,776) |
| Effect of changing pension and postretirement plans' measurement date pursuant to ASC Topic 715 | (3,935) | — |
| Net change in unrealized gains on investments | 827 | (38,931) |
| Net assets released from restrictions used for purchase of property and equipment | 10,648 | 8,342 |
| Decrease in interest in net assets of Rhode Island Hospital Foundation | (3,690) | (10,910) |
| Increase in noncontrolling interest in affiliate | 2,616 | 512 |
| | (40,165) | (18,047) |
| Decrease in unrestricted net assets | | |
| Temporarily restricted net assets: | | |
| Reclassification from adoption of UPMIFA (note 3(j)) | 97,284 | — |
| Gifts, grants and bequests | 57,919 | 57,438 |
| Income from restricted endowment and other restricted investments | 2,170 | 3,931 |
| Increase (decrease) in interest in net assets of Rhode Island Hospital Foundation | 703 | (2,949) |
| Transfers from Rhode Island Hospital Foundation | 6,033 | 5,704 |
| Net assets released from restrictions | (71,487) | (73,376) |
| Net realized and unrealized losses on investments | (5,673) | (20,380) |
| Appropriation from permanently restricted net assets | — | 2,059 |
| | 86,949 | (27,573) |
| Increase (decrease) in temporarily restricted net assets | | |
| Permanently restricted net assets: | | |
| Reclassification from adoption of UPMIFA (note 3(j)) | (97,284) | — |
| Net unrealized losses on investments | (340) | (30,963) |
| Net realized gains on sales of permanently restricted investments | — | 3,748 |
| (Decrease) increase in interest in net assets of Rhode Island Hospital Foundation | (4,272) | 1,220 |
| Appropriation to temporarily restricted net assets | — | (2,059) |
| Other decreases | (16) | — |
| | (101,912) | (28,054) |
| Decrease in permanently restricted net assets | | |
| Decrease in net assets | (55,128) | (73,674) |
| Net assets, beginning of year | 714,186 | 787,860 |
| Net assets, end of year | \$ 659,058 | \$ 714,186 |

See accompanying notes to consolidated financial statements.

RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended September 30, 2009 and 2008

(In thousands)

| | 2009 | 2008 |
|---|-------------|-------------|
| Cash flows from operating activities: | | |
| Decrease in net assets | \$ (55,128) | \$ (73,674) |
| Adjustments to reconcile decrease in net assets to net cash provided by operating activities: | | |
| Change in funded status of pension and other postretirement plans, other than net periodic pension and postretirement benefit costs | 57,439 | 4,776 |
| Effect of changing pension and postretirement plans' measurement date pursuant to ASC Topic 715 | 3,935 | — |
| Net realized and unrealized losses on investments | 14,088 | 85,088 |
| Undistributed portion of change in interest in net assets of Rhode Island Hospital Foundation | 7,259 | 12,639 |
| Transfers from Rhode Island Hospital Foundation | (6,033) | (5,704) |
| Depreciation and amortization | 32,698 | 31,024 |
| Provision for estimated health care benefit self-insurance costs | 59,248 | 51,131 |
| Decrease in liabilities for estimated health care benefit self-insurance costs resulting from claims paid | (58,028) | (52,353) |
| Net (increase) decrease in patient accounts receivable | (10,785) | 3,120 |
| Increase (decrease) in accounts payable | 501 | (4,579) |
| Increase in accrued employee benefits and compensation | 11,624 | 3,240 |
| Increase (decrease) in estimated third-party payor settlements | 7,816 | (4,228) |
| (Decrease) increase in all other current and noncurrent assets and liabilities, net | (5,593) | 8,645 |
| Net cash provided by operating activities | 59,041 | 59,125 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (42,314) | (65,747) |
| Net (increase) decrease in trustee-held bond funds | (45,852) | 895 |
| Other net decreases (increases) in assets limited as to use | 1,612 | (2,481) |
| Net cash used in investing activities | (86,554) | (67,333) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of long-term debt | 72,441 | — |
| Payments on long-term debt | (3,371) | (1,418) |
| Transfers from Rhode Island Hospital Foundation | 6,033 | 5,704 |
| Net cash provided by financing activities | 75,103 | 4,286 |
| Net increase (decrease) in cash and cash equivalents | 47,590 | (3,922) |
| Cash and cash equivalents, beginning of year | 34,337 | 38,259 |
| Cash and cash equivalents, end of year | \$ 81,927 | \$ 34,337 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 10,861 | \$ 10,310 |

See accompanying notes to consolidated financial statements.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(1) Description of Organization

Rhode Island Hospital (the Hospital), located in Providence, Rhode Island, is a 719-bed nonprofit general acute care teaching hospital with university affiliation providing a comprehensive range of diagnostic and therapeutic services (excluding obstetrics) for the acute care of patients principally from Rhode Island and southeastern Massachusetts. As a complement to its role in service and education, the Hospital actively supports research. The Hospital is accredited by the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) and participates as a provider primarily in Medicare, Blue Cross and Medicaid programs. The Hospital is also a member of Voluntary Hospitals of America, Inc. (VHA).

Effective August 9, 1994, the Federal Trade Commission and the Health Services Council of the Rhode Island Department of Health approved the combination of the Hospital and The Miriam Hospital (TMH) of Providence, RI (247 beds) under a plan which included the creation of a not-for-profit parent company, Lifespan Corporation. Each hospital continues to maintain its own identity and Board of Trustees, as well as its own campus and its own name. Lifespan has the responsibility for strategic planning and initiatives, capital and operating budgets, and overall governance of the consolidated organization.

(2) Charity Care and Other Community Benefits

The total net cost of charity care and other community benefits provided by the Hospital for the years ended September 30, 2009 and 2008 is summarized in the following table:

| | <u>2009</u> | <u>2008</u> |
|---|------------------|------------------|
| Charity care | \$ 29,272 | \$ 25,975 |
| Medical education, net | 41,277 | 41,243 |
| Research | 9,414 | 10,406 |
| Subsidized health services | 5,973 | 6,139 |
| Community health improvement services and community benefit operations | <u>754</u> | <u>774</u> |
| Total | <u>\$ 86,690</u> | <u>\$ 84,537</u> |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(2) Charity Care and Other Community Benefits (continued)

Charity Care

The Hospital provides full charity care for individuals at or below twice the federal poverty level, with a sliding scale for individuals up to four times the poverty level. In addition, a substantial charity allowance is offered to all other uninsured patients. The Hospital maintains records to identify and monitor the level of charity care it provides. The total cost incurred by the Hospital to provide charity care amounted to \$29,272 and \$25,975 in 2009 and 2008, respectively. Charges forgone, based on established rates, amounted to \$117,138 and \$103,781 in 2009 and 2008, respectively.

Medical Education

The Hospital provides the setting for and substantially supports medical education in various clinical training and nursing programs. The total cost of medical education provided by the Hospital exceeds the reimbursement received from third-party payors by \$41,277 and \$41,243 in 2009 and 2008, respectively.

In 1969, the Hospital and certain other Rhode Island hospitals entered into an affiliation agreement to participate jointly in various clinical training programs and research activities with Brown Medical School, renamed The Warren Alpert Medical School of Brown University (Brown). In 2004, Brown and Lifespan Corporation (Lifespan) created the Brown-Lifespan Partnership to expand their affiliation agreement. The goals of the partnership are: to bring together essential resources of Brown and Lifespan, including faculty appointments; to enhance the strategic focus on and opportunities in clinical programs, teaching and research; and to ensure the excellence of academic and clinical programs. The Hospital sponsors 44 graduate medical education programs accredited by or under the auspices of the Accreditation Council for Graduate Medical Education (ACGME), while also sponsoring another 24 hospital-approved residency and fellowship programs. The Hospital serves as the principal setting for these clinical training programs, which encompass the following disciplines: internal medicine and medicine subspecialties, including hematology and oncology; orthopedics and orthopedic subspecialties; clinical neurosciences; general surgery and surgical specialties; pediatrics and pediatric specialties, including hematology and oncology; dermatology; radiology; pathology; child psychiatry; emergency medicine and emergency medicine specialties.

The Hospital is also a participating clinical training site for residents in anesthesiology, emergency medicine, family medicine, infectious diseases, obstetrics/gynecology (OB/Gyn) and OB/Gyn subspecialties, otolaryngology, podiatry, psychiatry, orthopedics, pulmonary medicine, colorectal surgery, and radiation oncology programs and provides stipends to residents and physician fellows while in training.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(2) Charity Care and Other Community Benefits (continued)

With respect to nursing education, the Hospital has developed formal and informal educational affiliations with the University of Rhode Island College of Nursing; Rhode Island College; the Community College of Rhode Island; Salve Regina University; Boston College; Yale University; Regis College; Simmons College; St. Joseph's Health Services School of Nursing; and the University of Massachusetts-Dartmouth; the University of Connecticut; and the University of Pennsylvania, pursuant to which their nursing students obtain clinical training and experience at the Hospital. The Hospital does not receive any compensation from the various schools for providing a clinical setting for the student nurse training.

The Hospital sponsors training programs in the following medical fields: medical technology; diagnostic medical sonography; nuclear medical technology; radiologic technology; mammography; computerized tomography; magnetic resonance imaging; and pharmacy technician. At the Hospital, clinical affiliations/student clinical training programs are provided through contracts with a number of colleges and universities in the professional areas of speech-language pathology and audiology, physical therapy and occupational therapy. In addition, the Hospital serves as the clinical setting for training programs in histology, phlebotomy, child development and social work.

Research

The Hospital conducts extensive medical research and is in the forefront of biomedical health care delivery research and among the leaders nationally in National Institutes of Health programs. The Hospital also sponsors a significant level of these research activities, as indicated in the table on page 6.

Federal support accounts for approximately 74% of all externally funded research at the Hospital. Researchers focus on clinical trials which investigate prevention and treatment of HIV/AIDS, obesity, cancer, diabetes, cardiac disease, neurological problems and mental health concerns. Researchers may work in the laboratory or with patients, or both.

Subsidized Health Services

The Hospital subsidizes various health services including the following clinics: surgical, diabetes, resident/fellowships specialty training, dental, adolescent and Alzheimer's as well as the Center for Special Children and early intervention.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(2) Charity Care and Other Community Benefits (continued)

Community Health Improvement Services and Community Benefit Operations

The Hospital also provides numerous other services to the community for which charges are not generated. These services include certain emergency services, community health screenings for cardiac health, prostate cancer and other diseases, smoking cessation and weight loss programs, diabetes education, patient advocacy, foreign language translation, physician referral services and charitable contributions.

(3) Summary of Significant Accounting Policies

(a) *Basis of Presentation*

The consolidated financial statements also include the accounts of RIH Ventures (RIHV), Hospital Properties, Inc. (HPI) and Radiosurgery Center of Rhode Island, LLC (RCRI). Operations of RIHV include phlebotomy services which facilitate laboratory specimen testing, as well as parking facilities that serve patients and staff of the Hospital. HPI owns and operates a physicians' office building on behalf of the Hospital. RIH owns a 55% interest in RCRI, a limited liability company formed to operate a radiation therapy center utilizing cyberknife technology. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Hospital considers events and transactions that occur after the statement of financial position date, but before the consolidated financial statements are issued, to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. These consolidated financial statements were issued on February 19, 2010 and subsequent events have been evaluated through that date.

(b) *Use of Estimates*

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

(c) *Accounting Pronouncements Adopted in 2009*

On October 1, 2008 the Hospital adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 820-10, *Fair Value Measurements and Disclosures* (ASC 820-10). ASC 820-10 establishes an authoritative definition of fair value, sets out a framework for measuring fair value, and requires additional

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

disclosures about fair value measurements. See note 5 for disclosures of fair value required by ASC 820-10.

Effective October 1, 2008, the Hospital adopted the provisions of FASB ASC Subtopic 958-250, *Classification of Donor-Restricted Endowment Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act* (ASC 958-250). ASC 958-250 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and also requires disclosures about endowment funds, both donor-restricted endowment funds and board-designated endowment funds. See note 5 for disclosures of endowment funds required by ASC 958-250.

Effective September 30, 2009, the Hospital adopted the provisions of FASB ASC Subtopic 855-10, *Subsequent Events* (ASC 855-10). ASC 855-10 defines subsequent events and transaction periods, those circumstances under which the events or transactions should be recognized, and disclosures regarding subsequent events or transactions. ASC 855-10 is effective for annual periods ending after June 15, 2009. Although the adoption of ASC 855-10 did not affect the Hospital's consolidated financial statements, additional disclosures are now included under *Basis of Presentation* above.

In June 2009, the FASB issued Accounting Standards Update (ASU) 2009-1 (Codification). The Codification does not change U.S. generally accepted accounting principles, but combines all authoritative standards issued by organizations that are in levels A through D of the generally accepted accounting principles hierarchy, such as the FASB, American Institute of Certified Public Accountants, and Emerging Issues Task Force, into a comprehensive, topically organized online database. No accounting impact occurred since this is an accumulation of existing guidance. The Codification became effective for reporting periods that end after September 15, 2009.

(d) Accounting Pronouncements Not Yet Adopted

In December 2008, the FASB issued ASC Sections 715-20-50 and 55, *Employers' Disclosures about Postretirement Benefit Plan Assets*, which require additional disclosures for employers' pension and other postretirement benefit plan assets. The guidance requires employers to disclose information about fair value measurements of plan assets similar to the disclosures required under ASC Subtopic 820-10. Those disclosures will include the investment policies and strategies for the major categories of plan assets, as well as significant concentrations of risk within plan assets. ASC Sections 715-20-50 and 55 are effective for annual periods ending after December 15, 2009. The Hospital does not believe the adoption of ASC Sections 715-20-50 and

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

55 will have a material impact on its consolidated financial position, results of operations or cash flows since their requirements are limited to additional disclosures.

(e) *Cash and Cash Equivalents*

Cash and cash equivalents include all highly liquid debt instruments with maturities of three months or less when purchased, excluding amounts limited as to use by board-designation or other arrangements under trust agreements.

(f) *Investments and Investment Income*

As noted above, effective October 1, 2008, the Hospital adopted the recognition and disclosure provisions of ASC 820-10. ASC 820-10 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Fair value represents the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants as of the measurement date. ASC 820-10 establishes a fair value hierarchy that prioritizes inputs used to measure fair value into three levels:

- Level 1 – quoted prices (unadjusted) in active markets that are accessible at the measurement date;
- Level 2 – observable prices that are based on inputs not quoted in active markets, but corroborated by market data; and
- Level 3 – unobservable inputs that are used when little or no market data is available.

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In determining fair value, the Hospital utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The adoption of ASC 820-10 did not have an impact on the Hospital's consolidated financial position, changes in net assets, or cash flows, but did significantly expand fair value disclosures.

Following is a description of the valuation methodologies used for investments measured at fair value:

Cash and short-term investments: Valued at the net asset value (NAV) reported by the financial institution.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

U.S. government/agency and corporate obligations: Valued using market quotations or prices obtained from independent pricing sources which may employ various pricing methods to value the investments.

Corporate equity securities: Valued at the closing price reported by an active market in which the individual securities are traded.

Collective investment funds: Valued using NAV as reported by the investment manager, which approximates the market values of the underlying investments within the fund or realizable value as estimated by the investment manager.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated statements of financial position. Investments in collective investment funds with monthly pricing and liquidity are measured based on the fair value of the underlying investments; otherwise, such investments are recorded at historical cost. Investments of less than 5% in limited partnerships are also recorded at historical cost. Investments of 5% or more in limited partnerships, limited liability corporations or similar investments are accounted for at fair value, with changes in fair value recorded as realized gains or losses in each net asset class using the equity method. Investments in derivative financial instruments are not material.

The Hospital has applied the accounting guidance in Accounting Standards Update No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)* (ASU 2009-12), which permits the use of NAV or its equivalent reported by each underlying alternative investment fund as a practical expedient to estimate the fair value of the investment. These investments are generally redeemable or may be liquidated at NAV under the original terms of the subscription agreements or operations of the underlying funds. However, it is possible that these redemption rights may be restricted by the funds in the future in accordance with the underlying fund agreements, as applicable. Changes in market conditions, the economic environment, or the funds' liquidity provisions may significantly impact the NAV of the funds and, consequently, the fair value of the Hospital's interests in the funds. Although certain investments may be sold in a secondary market, the secondary market is not active and individual transactions are not necessarily observable. It is therefore reasonably possible that if the Hospital were to sell a fund in the secondary market, the sale could occur at an amount materially different than the reported value.

Effective October 1, 2008, the Hospital reclassified \$164,350 of its assets limited as to use from available-for-sale securities to trading securities. Investments designated by the Hospital as trading assets are reported at fair value, with gains or losses resulting from changes in fair value

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

recognized in the consolidated statement of operations and changes in net assets as realized gains or losses on investments.

Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments other than those designated as trading assets or those accounted for using the equity method are excluded from the excess of revenues over expenses.

Realized gains or losses on sales of investments are determined by the average cost method. Realized gains or losses on unrestricted investments are recorded as nonoperating gains or losses; realized gains or losses on restricted investments are recorded as an addition to or deduction from the appropriate restricted net assets. A decline in the market value of an investment security below its cost that is designated to be other than temporary is recognized through an impairment charge classified as a realized loss and a new cost basis is established.

Investment income from funds held by trustees under bond indenture agreements is recorded as other revenue. Lifespan maintains a spending policy for certain board-designated funds of its patient care affiliates which provides that investment income from such funds is recorded within unrestricted revenues as endowment earnings contributed toward community benefit.

Income from permanently restricted investments is recorded as nonoperating gains when unrestricted by donor and as an addition to the net assets of the appropriate temporarily restricted fund when restricted by donor.

(g) *Assets Limited As To Use*

Assets limited as to use primarily include designated assets set aside by the Hospital's Board for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, and assets whose use by the Hospital has been permanently restricted by donors or limited by grantors or donors to a specific purpose, as well as assets held by trustees under bond indenture agreements and irrevocable split-interest trusts. Amounts required to meet current liabilities of the Hospital are reported in current assets in the consolidated statements of financial position.

(h) *Property and Equipment*

Property and equipment acquisitions are recorded at cost. Depreciation is computed over the estimated useful life of each class of depreciable asset using the straight-line method. Buildings and improvements lives range from 5 to 40 years and equipment from 3 to 20 years. Net interest

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(i) *Deferred Financing Costs*

Deferred financing costs, which relate to the issuance of long-term bonds payable to the Rhode Island Health and Educational Building Corporation (RIHEBC), are being amortized ratably over the periods the bonds are outstanding.

(j) *Classification of Net Assets*

As noted above, effective October 1, 2008, the Hospital adopted the provisions of ASC 958-250, which provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and also requires disclosures about endowment funds, including donor-restricted endowment funds and board-designated endowment funds.

The Hospital is incorporated in and subject to the laws of Rhode Island, which adopted UPMIFA effective as of June 30, 2009. Under UPMIFA, the assets of a donor-restricted endowment fund may be appropriated for expenditure by the Hospital in accordance with the standard of prudence prescribed by UPMIFA. As a result of this new law and the adoption of ASC 958-250, the Hospital has classified its September 30, 2009 net assets as follows:

- *Permanently restricted net assets* contain donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by actions of the Hospital and primarily consist of the historic dollar value of contributions to establish or add to donor-restricted endowment funds.
- *Temporarily restricted net assets* contain grantor or donor-imposed stipulations as to the timing of their availability or use for a particular purpose, including research activities. These net assets are released from restrictions when the specified time elapses or when actions have been taken to meet the restrictions. Net assets of donor-restricted endowment funds in excess of their historic dollar value are classified as temporarily restricted net assets until appropriated by the Hospital and spent in accordance with the standard of prudence imposed by UPMIFA.
- *Unrestricted net assets* contain no donor-imposed restrictions and are available for the general operations of the Hospital. Such net assets may be designated by the Hospital for specific purposes, including to function as endowment funds.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

Prior to 2009, the Hospital was subject to the Rhode Island Uniform Management of Institutional Funds Act (UMIFA), as amended. Rhode Island's enacted version of UMIFA required the Hospital to maintain the purchasing power of the historic dollar value of its donor-restricted endowment funds and, as a result, the Hospital annually added a portion of the funds' return to permanently restricted net assets to account for inflation. This requirement was eliminated by the enactment of UPMIFA and, accordingly, in 2009 the Hospital reclassified the \$97,284 cumulative amount of such additions from permanently restricted net assets to temporarily restricted net assets. See note 5 for more information about the Hospital's endowment.

(k) *Excess of Revenues Over Expenses*

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include, the change in the funded status of pension and other postretirement plans, the effect of changing pension and other postretirement plans' measurement date pursuant to ASC Topic 715, unrealized gains and losses on investments, net assets released from restrictions used for purchase of property and equipment, the change in interest in net assets of Rhode Island Hospital Foundation, and the increase in noncontrolling interest in affiliate.

(l) *Net Patient Service Revenue*

The Hospital provides care to patients under Medicare, Medicaid, managed care and commercial insurance contractual arrangements. The Hospital has agreements with many third-party payors that provide for payments to the Hospital at amounts less than its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with some third-party payors.

Medicare utilizes a prospective payment system for most inpatient hospital services rendered to Medicare program beneficiaries based on the classification of each case into a diagnostic-related group (DRG). Medicare outpatient hospital services are primarily paid using an ambulatory payment classification system.

Most hospital services to Rhode Island Medicaid patients are reimbursed based on negotiated costs under a prospective cost arrangement. The tentative hospital reimbursement rates are determined by certain negotiated budgeted expenditures and budgeted volume. Variances from budgeted volume are reimbursable at rates which may differ from the budgeted rate.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

The majority of payments from managed care and commercial insurance companies are based upon negotiated fixed pricing arrangements, whereby a combination of per diem rates and specific case rates are utilized for inpatient services, along with fixed fees applicable to outpatient services.

Settlements and adjustments arising under reimbursement arrangements with some third-party payors, primarily Medicare, Medicaid and Blue Cross, are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Hospital has classified a portion of accrued estimated third-party payor settlements as long-term because such amounts, by their nature or by virtue of regulation or legislation, will not be paid within one year. Changes in the Medicare and Medicaid programs, such as the reduction of reimbursement, could have an adverse impact on the Hospital.

(m) *Provision for Bad Debts*

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements. Additions to the allowance for doubtful accounts are made by means of the provision for bad debts. Accounts deemed uncollectible are deducted from the allowance and subsequent recoveries are added. The amount of the provision for bad debts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental health care coverage and other collection indicators.

(n) *Charity Care*

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

(o) *Donor-Restricted Gifts*

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. The gifts are reported as temporarily or permanently restricted support that increase those net asset classes if they are received with stipulations that limit the use of the assets. When a donor or grantor restriction expires, that is, when a stipulated purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

(p) *Inventories*

Inventories, consisting primarily of medical/surgical supplies and pharmaceuticals, are stated at the lower of cost or market.

(q) *Estimated Self-Insurance Costs*

The Hospital participates in Lifespan self-insurance programs with other Lifespan affiliates for losses arising from medical malpractice claims, health benefits to its employees, and losses arising from workers' compensation claims. The Hospital has recorded provisions for estimated claims, which are based on Lifespan's own experience. The provisions for self-insured losses include estimates of the ultimate costs for both reported claims and claims incurred but not reported.

(r) *Fair Value of Financial Instruments*

The carrying amounts recorded in the consolidated statements of financial position for cash and cash equivalents, patient accounts receivable, assets limited as to use, accounts payable, accrued expenses, estimated third-party payor settlements, and estimated health care benefit self-insurance costs approximate their respective fair values. The estimated fair value of the Hospital's assets limited as to use and long-term debt are disclosed in notes 5 and 11, respectively.

(s) *Reclassifications*

Certain 2008 amounts have been reclassified to conform with the 2009 reporting format.

(4) Disproportionate Share

The Hospital is a participant in the State of Rhode Island's Disproportionate Share Program, established in 1995 to assist hospitals which provide a disproportionate amount of uncompensated care. Under the program, Rhode Island hospitals, including the Hospital, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. Total payments to the Hospital under the Disproportionate Share Program aggregated \$44,326 and \$37,245 in 2009 and 2008, respectively, and are reflected as part of net patient service revenue in the accompanying consolidated statements of operations and changes in net assets.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(4) Disproportionate Share (continued)

The State of Rhode Island has assessed a license fee to all Rhode Island hospitals, based on each hospital's 2007 net patient service revenue as defined. The Hospital's license fee expense was \$40,868 and \$24,408 in 2009 and 2008, respectively. The hospitals in the State of Rhode Island accepted the fee as part of an agreement with the State's Department of Health and Human Services in return for an equitable distribution of funds to those hospitals meeting certain criteria in providing services to the Medicaid population.

For periods beyond 2009, the federal government could change the level of federal matching funds for the Disproportionate Share Program. Accordingly, it may be necessary for the State of Rhode Island to modify the program and the reimbursement to Rhode Island hospitals under the program. At this time, the scope of such modifications or their effect on the Hospital cannot be reasonably determined.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(5) Investments

The composition of assets limited as to use at September 30, 2009 and 2008 is set forth in the following table.

| | 2009 | 2008 |
|--|-------------|-------------|
| Unrestricted board-designated funds: | | |
| Cash and short-term investments | \$ 872 | \$ — |
| U.S. government and agency obligations | 14,299 | 7,239 |
| Corporate equity securities | 20,054 | 40,432 |
| Corporate obligations | 11,509 | 10,594 |
| Collective investment funds | 127,647 | 118,296 |
| Other investments | 540 | 577 |
| | 174,921 | 177,138 |
| Held by trustee under bond indenture agreements: | | |
| Cash and short-term investments | 39,833 | 1,236 |
| U.S. government and agency obligations | 7,255 | — |
| | 47,088 | 1,236 |
| Temporarily restricted funds: | | |
| Cash and short-term investments | 945 | — |
| U.S. government and agency obligations | 15,501 | 4,303 |
| Corporate equity securities | 21,740 | 24,035 |
| Corporate obligations | 12,477 | 6,297 |
| Collective investment funds | 138,378 | 70,321 |
| | 189,041 | 104,956 |
| Permanently restricted funds: | | |
| Cash and short-term investments | 190 | — |
| U.S. government and agency obligations | 3,116 | 5,545 |
| Corporate equity securities | 4,370 | 30,970 |
| Corporate obligations | 2,508 | 8,114 |
| Collective investment funds | 27,812 | 90,611 |
| Other investments | 118 | 442 |
| | 38,114 | 135,682 |
| Total | \$ 449,164 | \$ 419,012 |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(5) Investments (continued)

Trading Securities

Effective October 1, 2008, the Hospital reclassified certain of its assets limited as to use from available-for-sale securities to trading securities. The gains recognized as a result of this transfer amounted to \$15,849.

Assets limited as to use at September 30 are classified as follows:

| | 2009 | 2008 |
|--------------------|------------|------------|
| Available-for-sale | \$ 305,966 | \$ 419,012 |
| Trading | 143,198 | — |
| Total | \$ 449,164 | \$ 419,012 |

Fair Value

The following table summarizes the Hospital's investments and assets held in trust in the ASC 820-10 fair value hierarchy as of September 30, 2009:

| | Level 1 | Level 2 | Level 3 | Total |
|--|------------|------------|-----------|------------|
| Investments: | | | | |
| Cash and short-term investments | \$ 48,643 | \$ — | \$ — | \$ 48,643 |
| U.S. government and agency obligations | 10,130 | 7,255 | — | 17,385 |
| Corporate equity securities | 44,470 | — | — | 44,470 |
| Corporate obligations | — | 39,542 | — | 39,542 |
| Collective investment funds | 54,161 | 181,429 | — | 235,590 |
| | 157,404 | 228,226 | — | 385,630 |
| Assets held in trust (Note 6) | — | — | 11,275 | 11,275 |
| Total | \$ 157,404 | \$ 228,226 | \$ 11,275 | \$ 396,905 |

Investments in collective investment funds which do not have monthly pricing and liquidity are recorded at historical cost. Investments of less than 5% in limited partnerships are also recorded at historical cost. The aggregate historical cost of these investments, which approximates market value as reported by investment managers, amounted to \$52,259 at September 30, 2009. During 2009 and 2008 there were no declines in market values of any of these investments below their cost which were designated to be other than temporary.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(5) Investments (continued)

Most investments classified in Level 2 consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Because the NAV reported by each fund is used as a practical expedient to estimate the fair value of the Hospital's interest therein, its classification in Level 2 is based on the Hospital's ability to redeem its interest at or near the date of the consolidated statement of financial position. The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities.

The following table presents the Hospital's activity for the fiscal year ended September 30, 2009 for investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820-10:

| | <u>Assets held in trust</u> |
|------------------------------------|-------------------------------------|
| Fair value at October 1, 2008 | \$ 11,615 |
| Net realized and unrealized losses | <u>(340)</u> |
| Fair value at September 30, 2009 | <u>\$ 11,275</u> |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(5) Investments (continued)

Investment Income, Gains and Losses

Investment income, gains and losses for cash equivalents and assets limited as to use are comprised of the following for the years ended September 30:

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|--------------------|
| Other revenue: | | |
| Investment income | \$ <u>146</u> | \$ <u>908</u> |
| Endowment earnings contributed toward community benefit: | | |
| Dividend and interest income | \$ <u>6,570</u> | \$ <u>6,895</u> |
| Nonoperating gains and losses: | | |
| Net realized (losses) gains on board-designated investments | \$ <u>(8,902)</u> | \$ <u>1,438</u> |
| Other changes in unrestricted net assets: | | |
| Net change in unrealized gains on investments | \$ <u>827</u> | \$ <u>(38,931)</u> |
| Changes in temporarily restricted net assets: | | |
| Income from restricted endowment and other restricted investments | \$ 2,170 | \$ 3,931 |
| Net realized and unrealized losses on investments | <u>(5,673)</u> | <u>(20,380)</u> |
| | <u>\$ (3,503)</u> | <u>\$ (16,449)</u> |
| Changes in permanently restricted net assets: | | |
| Net unrealized losses on investments | \$ (340) | \$ (30,963) |
| Net realized gains on permanently restricted investments | <u>—</u> | <u>3,748</u> |
| | <u>\$ (340)</u> | <u>\$ (27,215)</u> |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(5) Investments (continued)

Liquidity

Investments as of September 30, 2009 are summarized below based on when they may be redeemed or sold:

| | |
|---------------------------------------|-------------------|
| Investment redemption or sale period: | |
| Daily | \$ 286,626 |
| Monthly | 43,277 |
| Quarterly | 47,958 |
| One-to-five years | 391 |
| Locked-up until liquidation | <u>7,378</u> |
| Total | <u>\$ 385,630</u> |

Locked-up until liquidation includes trustee-held debt service reserve funds under bond indenture agreements.

Commitments

Energy, venture capital, private equity and certain real estate investments are generally made through limited partnerships. Under the terms of these agreements, the Hospital is obligated to remit additional funding periodically as capital or liquidity calls are exercised by the manager. These partnerships have a limited existence, generally ten years, and such agreements may provide for annual extensions for the purpose of disposing portfolio positions and returning capital to investors. However, depending on market conditions, the inability to execute the fund's strategy, and other factors, a manager may extend the terms of a fund beyond its originally anticipated existence or may wind the fund down prematurely. The Hospital cannot anticipate such changes because they are based on unforeseen events, but should they occur they may result in less liquidity or return from the investment than originally anticipated. As a result, the timing and amount of future capital or liquidity calls expected to be exercised in any particular future year is uncertain. The aggregate amount of unfunded commitments associated with the above noted investment categories as of September 30, 2009 was \$8,433.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(5) Investments (continued)

Investments With Unrealized Losses

Information regarding investments with unrealized losses at September 30, 2009 and 2008 is presented below, segregated between those that have been in a continuous unrealized loss position for less than twelve months and those that have been in a continuous unrealized loss position for twelve or more months:

| | <u>Less than 12 months</u> | | <u>12 months or longer</u> | | <u>Total</u> | |
|---|----------------------------|--------------------------|----------------------------|--------------------------|-------------------|--------------------------|
| | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> |
| <u>September 30, 2009:</u> | | | | | | |
| Unrestricted board-designated and temporarily restricted funds: | | | | | | |
| Collective investment funds | \$ — | \$ — | \$ 27,562 | \$ 5,034 | \$ 27,562 | \$ 5,034 |
| Total temporarily impaired securities | \$ — | \$ — | \$ 27,562 | \$ 5,034 | \$ 27,562 | \$ 5,034 |
| | | | | | | |
| | <u>Less than 12 months</u> | | <u>12 months or longer</u> | | <u>Total</u> | |
| | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> |
| <u>September 30, 2008:</u> | | | | | | |
| Unrestricted board-designated, temporarily restricted and permanently restricted funds: | | | | | | |
| Collective investment funds | \$ 125,159 | \$ 20,466 | \$ — | \$ — | \$ 125,159 | \$ 20,466 |
| Total temporarily impaired securities | \$ 125,159 | \$ 20,466 | \$ — | \$ — | \$ 125,159 | \$ 20,466 |

In the evaluation of whether an impairment is other than temporary, the Hospital considers the reasons for the impairment, its ability and intent to hold the investment until the market price recovers, the severity and duration of the impairment, and expected future performance. Based on this evaluation, no impairment was considered to be other than temporary.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(5) Investments (continued)

Securities Lending

The Hospital participates in a securities lending program in which it lends a portion of its investments to pre-approved third party borrowers that meet certain criteria through a lending agent. All securities on loan are fully collateralized by cash or debt instruments in amounts greater than the market value of the securities on loan. The lending agent is responsible for ensuring the creditworthiness of the borrowers and investing collateral assets in high quality securities. These investments consist primarily of U.S. dollar-denominated fixed income adjustable rate securities and U.S. government securities with short maturities.

Endowments

The Hospital's endowment consists of approximately 309 individual funds established for a variety of purposes, including both donor-restricted endowment funds and funds designated by the Hospital to function as endowments. Investments associated with endowment funds, including funds designated by the Hospital to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Endowment funds consist of the following at September 30, 2009:

| | <u>Unrestricted board-designated</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|--|-----------------------------------|-----------------------------------|-------------------|
| Donor-restricted endowment funds | \$ — | \$ 189,041 | \$ 38,114 | \$ 227,155 |
| Unrestricted board-designated endowment funds | <u>174,921</u> | <u>—</u> | <u>—</u> | <u>174,921</u> |
| Total endowment funds | <u>\$ 174,921</u> | <u>\$ 189,041</u> | <u>\$ 38,114</u> | <u>\$ 402,076</u> |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

Endowments (continued)

Endowment funds consist of the following at September 30, 2008:

| | <u>Unrestricted board-designated</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|--|-----------------------------------|-----------------------------------|-------------------|
| Donor-restricted endowment funds | \$ — | \$ 104,956 | \$ 135,682 | \$ 240,638 |
| Unrestricted board-designated endowment funds | <u>177,138</u> | <u>—</u> | <u>—</u> | <u>177,138</u> |
| Total endowment funds | <u>\$ 177,138</u> | <u>\$ 104,956</u> | <u>\$ 135,682</u> | <u>\$ 417,776</u> |

Changes in endowment funds for the year ended September 30, 2009 are as follows:

| | <u>Unrestricted board-designated</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|---|--|-----------------------------------|-----------------------------------|-------------------|
| Endowment funds, October 1, 2008 | \$ 177,138 | \$ 104,956 | \$ 135,682 | \$ 417,776 |
| Reclassification from adoption of UPMIFA | — | 97,284 | (97,284) | — |
| Interest and dividend income | 6,600 | 2,170 | — | 8,770 |
| Net realized and unrealized losses | (8,075) | (5,673) | (340) | (14,088) |
| Cash gifts, grants and bequests | — | 61,791 | — | 61,791 |
| Net assets released from restrictions | — | (71,487) | — | (71,487) |
| Deposits | 921 | — | — | 921 |
| Withdrawals | (1,663) | — | — | (1,663) |
| Other increases | <u>—</u> | <u>—</u> | <u>56</u> | <u>56</u> |
| Endowment funds, September 30, 2009 | <u>\$ 174,921</u> | <u>\$ 189,041</u> | <u>\$ 38,114</u> | <u>\$ 402,076</u> |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

Endowments (continued)

Changes in endowment funds for the year ended September 30, 2008 are as follows:

| | Unrestricted board-designated | Temporarily restricted | Permanently restricted | Total |
|--|--|-----------------------------------|-----------------------------------|--------------|
| Endowment funds, October 1, 2007 | \$ 210,607 | \$ 124,841 | \$ 164,935 | \$ 500,383 |
| Interest and dividend income | 7,313 | 3,931 | — | 11,244 |
| Net realized and unrealized losses | (37,493) | (20,380) | (27,215) | (85,088) |
| Cash gifts, grants and bequests | — | 67,881 | — | 67,881 |
| Net assets released from restrictions | — | (73,376) | — | (73,376) |
| Withdrawals | (3,289) | — | — | (3,289) |
| Appropriations from permanently restricted net assets | — | 2,059 | (2,059) | — |
| Other increases | — | — | 21 | 21 |
| | \$ 177,138 | \$ 104,956 | \$ 135,682 | \$ 417,776 |
| Endowment funds, September 30, 2008 | \$ 177,138 | \$ 104,956 | \$ 135,682 | \$ 417,776 |

(a) Interpretation of Relevant Law

The portion of donor-restricted endowment funds that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

Endowments (continued)

(b) Return Objectives and Risk Parameters

Lifespan has adopted investment policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets, including both donor-restricted funds and unrestricted board-designated funds. Under this policy, as approved by Lifespan, the endowment assets are invested in a manner that is intended to produce results that exceed the total benchmark return while assuming a moderate level of investment risk. The Hospital expects its endowment funds, over a full market cycle, to provide an average annual real rate of return of approximately 5.5% plus inflation annually. Actual returns in any given year or period of years may vary from this amount.

(c) Strategies Employed for Achieving Objectives

To satisfy its long-term rate of return objectives, Lifespan relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Lifespan targets a diversified asset allocation that places emphasis on investments in public equity, marketable alternatives, real assets and fixed income to achieve its long-term return objectives within prudent risk constraints.

(d) Spending Policy

As noted, the Hospital invests its endowment funds in accordance with the total return concept. Applicable endowments include unrestricted board-designated endowment funds and donor-restricted endowment funds. The governing board of the Hospital will be formalizing an endowment spending rate determination in 2010 based on all of the above factors. This spending rate will be applied to the average fair value of the applicable endowments for the immediately preceding three years.

(6) Assets Held in Trust

The Hospital is a beneficiary of various irrevocable split-interest trusts. The fair market value of these investments at September 30, 2009 and 2008 was approximately \$11,275 and \$11,615, respectively, and is reported as permanently restricted funds within assets limited as to use in the consolidated statements of financial position.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(7) Property and Equipment

Property and equipment, by major category, is as follows at September 30:

| | <u>2009</u> | <u>2008</u> |
|--|-------------------|-------------------|
| Land and improvements | \$ 23,695 | \$ 23,653 |
| Buildings and improvements | 630,749 | 562,783 |
| Equipment | <u>311,487</u> | <u>291,420</u> |
| | 965,931 | 877,856 |
| Less accumulated depreciation and amortization | <u>500,981</u> | <u>468,798</u> |
| | 464,950 | 409,058 |
| Construction in progress | <u>24,345</u> | <u>70,090</u> |
| Property and equipment, net | <u>\$ 489,295</u> | <u>\$ 479,148</u> |

Depreciation and amortization expense for the years ended September 30, 2009 and 2008 amounted to \$32,698 and \$31,024, respectively.

The estimated cost of completion of construction in progress approximated \$8,000 at September 30, 2009, comprised mainly of various building renovation projects. In addition, the Hospital has several building renovation projects pending contractual commitments with an estimated cost of completion of approximately \$6,000.

It is the Hospital's policy to capitalize the net amount of interest cost associated with significant capital additions as a component of the cost of such assets, which is amortized over the asset's estimated useful life. No interest was capitalized in 2009 and 2008.

(8) Pension and Other Postretirement Benefits

Change in Measurement Date of Pension and Other Postretirement Benefit Plans

Beginning in fiscal 2009, FASB ASC Topic 715, *Compensation-Retirement Benefits: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (ASC 715), requires Lifespan to measure the funded status of its benefit plans as of September 30. Lifespan formerly used a measurement date of June 30 for its benefit plans. Implementation of this change reduced Lifespan's unrestricted net assets by \$5,957, comprised of the following effects from July 1, 2008 through September 30, 2008:

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

| | Lifespan Corporation Retirement Plan | Lifespan Corporation Postretirement Benefit Plan | Total |
|---|---|---|--------------|
| Service cost | \$ 5,559 | \$ 122 | \$ 5,681 |
| Interest cost | 5,442 | 397 | 5,839 |
| Expected return on plan assets | (5,706) | — | (5,706) |
| Amortization of net actuarial loss | 77 | 106 | 183 |
| Amortization of prior service cost (benefit) | 224 | (264) | (40) |
| | | | |
| Total reduction to unrestricted net assets of Lifespan | \$ 5,596 | \$ 361 | \$ 5,957 |
| | | | |
| Total reduction to unrestricted net assets of the Hospital | \$ 3,539 | \$ 396 | \$ 3,935 |

Pension Benefits

Lifespan Corp. sponsors the Lifespan Corporation Retirement Plan (the Plan), which was established effective January 1, 1996 when the Rhode Island Hospital Retirement Plan (the RIH Plan) merged into The Miriam Hospital Retirement Plan. Upon completion of the merger, the new plan was renamed and is governed by provisions of the Lifespan Corporation Retirement Plan. Each employee who was a participant in the RIH Plan and was an eligible employee on January 1, 1996 continues to be a participant on and after January 1, 1996, subject to the provisions of the Plan. Employees are included in the Plan on the first of the month which is the later of their first anniversary of employment or the attainment of age 18.

The Plan is intended to constitute a plan described in Section 414(k) of the Internal Revenue Code, under which benefits are derived from employer contributions based on the separate account balances of participants in addition to the defined benefits provided under the Plan, which are based on an employee's years of credited service and annual compensation. Lifespan's funding policy is to contribute amounts to the Plan sufficient to meet minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code as amended, plus such additional amounts as may be determined to be appropriate by Lifespan.

Substantially all employees of Lifespan Corporation who meet the above requirements are eligible to participate in the Plan.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

The provisions of ASC 715 require an employer to recognize in its statement of financial position an asset for a benefit plan's overfunded status or a liability for a plan's underfunded status, and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. The funded-status amount is measured as the difference between the fair value of plan assets and the benefit obligation including all actuarial gains and losses and prior service cost. Based on September 30, 2009 funded-status amounts for the Hospital's portion of the Plan, the Hospital recorded a decrease in unrestricted net assets of \$58,954.

The estimated amounts that will be amortized from unrestricted net assets into net periodic pension cost in 2010 are as follows:

| | | |
|--------------------|----|-------|
| Net actuarial loss | \$ | 4,276 |
| Prior service cost | | 672 |
| | | 4,948 |
| | \$ | 4,948 |

The following tables set forth the Plan's projected benefit obligations and the fair value of plan assets.

| | 2009 | 2008 |
|--|-------------|-------------|
| Change in projected benefit obligation: | | |
| Projected benefit obligation at beginning of year | \$ 389,966 | \$ 382,309 |
| Effects of changing the Plan's measurement date: | | |
| Service cost and interest cost for July 1 – September 30, 2008 | 11,001 | — |
| Benefits paid for July 1 – September 30, 2008 | (3,716) | — |
| Service cost | 22,237 | 21,052 |
| Interest cost | 21,769 | 24,904 |
| Actuarial loss (gain) | 26,505 | (21,619) |
| Benefits paid | (13,858) | (15,844) |
| Administrative expenses | (928) | (836) |
| | | |
| Projected benefit obligation at end of year | \$ 452,976 | \$ 389,966 |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

The accumulated benefit obligation at the end of 2009 and 2008 was \$387,586 and \$339,725, respectively.

| | 2009 | 2008 |
|--|-------------------|-------------------|
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | \$ 351,770 | \$ 357,548 |
| Effects of changing the Plan's measurement date: | | |
| Benefits paid for July 1 – September 30, 2008 | (3,716) | — |
| Administrative expenses paid for July 1 – September 30, 2008 | (322) | — |
| Actual return on plan assets | (47,725) | (7,217) |
| Employer contributions | 22,554 | 18,119 |
| Benefits paid | (13,858) | (15,844) |
| Administrative expenses | (928) | (836) |
| | \$ 307,775 | \$ 351,770 |

The funded status of the Plan and amounts recognized in Lifespan's consolidated statements of financial position at September 30, pursuant to ASC Topic 715 (as opposed to ERISA), are as follows:

| | 2009 | 2008 |
|---|---------------------|--------------------|
| Funded status, end of year: | | |
| Fair value of plan assets | \$ 307,775 | \$ 351,770 |
| Projected benefit obligation | 452,976 | 389,966 |
| | \$ (145,201) | \$ (38,196) |
| | | |
| | 2009 | 2008 |
| Amounts not yet reflected in net periodic pension cost and included in unrestricted net assets: | | |
| Prior service cost | \$ (2,477) | \$ (3,698) |
| Accumulated net actuarial loss | (105,606) | (2,764) |
| Amounts not yet recognized as a component of net periodic pension cost | (108,083) | (6,462) |
| Accumulated net periodic pension cost in excess of employer contributions | (37,118) | (31,734) |
| | \$ (145,201) | \$ (38,196) |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Amounts recognized in the Hospital's consolidated statements of financial position at September 30, 2009 and 2008 are as follows:

| | <u>2009</u> | <u>2008</u> |
|--|--------------------|-------------------|
| Accrued pension liability | \$ <u>97,513</u> | \$ <u>35,000</u> |
| | | |
| | <u>2009</u> | <u>2008</u> |
| Sources of change in unrestricted net assets: | | |
| Net loss arising during the year | \$ (60,270) | \$ (6,782) |
| Amortizations: | | |
| Net actuarial loss (gain) | 443 | (506) |
| Prior service cost | 873 | 699 |
| Total unrestricted net asset loss recognized during the year | \$ <u>(58,954)</u> | \$ <u>(6,589)</u> |

Components of net periodic pension cost are as follows for the years ended September 30:

| | <u>2009</u> | <u>2008</u> |
|--|------------------|------------------|
| Service cost | \$ 22,237 | \$ 21,052 |
| Interest cost | 21,769 | 24,904 |
| Expected return on plan assets | (22,861) | (27,144) |
| Amortization of net actuarial loss (gain) | 208 | (798) |
| Amortization of prior service cost | 997 | 997 |
| | | |
| Net periodic pension cost for Lifespan | \$ <u>22,350</u> | \$ <u>19,011</u> |
| | | |
| Net periodic pension cost for the Hospital | \$ <u>13,804</u> | \$ <u>12,052</u> |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Net Periodic Pension Cost

The following weighted average assumptions were used by the Plan's actuary to determine net periodic pension cost and benefit obligations:

| | 2009 | 2008 |
|--|-------|-------|
| Discount rate for benefit obligations | 5.74% | 6.92% |
| Discount rate for net periodic pension cost | 6.92 | 6.25 |
| Rate of compensation increase | 4.50 | 4.50 |
| Expected long-term rate of return on Plan assets | 8.00 | 8.00 |

The asset allocation for the Plan at September 30, 2009 and June 30, 2008, and the target allocation for 2010, by asset category, are as follows:

| Asset Category | Target Allocation 2010 | Percentage of Plan Assets | |
|---------------------------|---------------------------|---------------------------|------------------|
| | | September 30, 2009 | June 30, 2008 |
| U.S. equity | 15 - 35% | 13.6% | 18.8% |
| Absolute return | 0 - 25% | 18.4 | 10.5 |
| International equity | 10 - 35% | 19.0 | 23.0 |
| Venture capital | 0 - 10% | 1.7 | 1.7 |
| Commodities | 0 - 20% | 6.9 | 14.9 |
| Real estate | 0 - 15% | 4.8 | 6.8 |
| Fixed income | 10 - 50% | 33.5 | 21.8 |
| Cash and cash equivalents | 0 - 10% | 2.1 | 2.5 |
| Total | | 100.0% | 100.0% |

The above table does not include \$63,508 and \$68,862 of Plan assets at September 30, 2009 and June 30, 2008, respectively, attributable to the separate savings account balances of participants which are managed in various mutual funds by Fidelity Investments.

The overall financial objective of the Plan is to meet present and future obligations to beneficiaries, while minimizing long-term contributions to the Plan (by earning an adequate return on Plan assets), with moderate volatility in year-to-year contribution levels.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

The primary investment objective of the Plan is to attain the expected long-term rate of return on Plan assets in support of the above objective. The Plan's specific investment objective is to attain an average annual real total return (net of investment management fees) of at least 5% over the long term (rolling five-year periods). Real total return is the sum of capital appreciation (or loss) and current income (dividends and interest) adjusted for inflation by the Consumer Price Index.

Lifespan employs a rigorous process to annually determine the expected long-term rate of return on Plan assets which is only changed based on significant shifts in economic and financial market conditions. These estimates are primarily driven by actual historical asset-class returns along with our long-term outlook for a globally diversified portfolio. Asset allocations are regularly updated based on evaluations of future market returns for each asset class.

Expected Cash Flows

Information about the expected cash flows for the Plan follows:

| | |
|----------------------------|-----------|
| Employer contributions: | |
| 2010 (expected) | \$ 25,727 |
| Expected benefit payments: | |
| 2010 | \$ 23,065 |
| 2011 | 22,233 |
| 2012 | 23,889 |
| 2013 | 26,738 |
| 2014 | 27,766 |
| 2015 through 2019 | 167,108 |

Management evaluates its Plan assumptions annually and the expected contribution in 2010 could increase.

Other Postretirement Benefits

In addition to providing pension benefits, the Hospital provides certain health care and life insurance benefits to retired employees. As of December 31, 2003, health care and life insurance postretirement benefits were eliminated for all active employees of the Hospital with fewer than fifteen years of consecutive service.

The Hospital recognizes in its statement of financial position an asset for a benefit plan's overfunded status or a liability for a plan's underfunded status, and recognizes changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. The funded-status amount

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

is measured as the difference between the fair value of plan assets and the benefit obligation including all actuarial gains and losses and prior service cost. Based on September 30, 2009 funded-status amounts for the Hospital's postretirement benefit plan, the Hospital recorded an increase in unrestricted net assets of \$1,515.

The estimated amounts that will be amortized from unrestricted net assets into net periodic postretirement benefit cost in 2010 are as follows:

| | | |
|-----------------------|----|----------------|
| Net actuarial loss | \$ | 201 |
| Prior service benefit | | <u>(1,017)</u> |
| | \$ | <u>(816)</u> |

Benefit Obligations

| | <u>2009</u> | <u>2008</u> |
|--|------------------|------------------|
| Change in benefit obligation: | | |
| Accumulated postretirement benefit obligation at beginning of year | \$ 22,634 | \$ 24,250 |
| Service cost and interest cost for July 1 – September 30, 2008 | 507 | — |
| Service cost | 483 | 567 |
| Interest cost | 1,546 | 1,505 |
| Benefits paid | (1,711) | (1,421) |
| Actuarial gain | <u>(1,543)</u> | <u>(2,267)</u> |
| Accumulated postretirement benefit obligation at end of year | <u>\$ 21,916</u> | <u>\$ 22,634</u> |

Funded Status

The Hospital has never funded its other postretirement benefit obligations. The funded status of the postretirement benefit plan, reconciled to the amount reported in the consolidated statements of financial position, follows:

| | <u>2009</u> | <u>2008</u> |
|---|--------------------|--------------------|
| Benefit obligations | \$ <u>21,916</u> | \$ <u>22,634</u> |
| Funded status | <u>(21,916)</u> | <u>(22,634)</u> |
| Accrued postretirement benefit cost recognized in the consolidated statements of financial position | <u>\$ (21,916)</u> | <u>\$ (22,634)</u> |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Amounts recognized in the consolidated statements of financial position at September 30, 2009 and 2008 consist of:

| | 2009 | 2008 |
|--|-------------|-------------|
| Accrued postretirement benefit cost: | | |
| Current (included in accrued employee benefits and compensation) | \$ 1,348 | \$ 1,627 |
| Noncurrent (included in other liabilities) | 20,568 | 21,007 |
| Total accrued postretirement benefit cost | \$ 21,916 | \$ 22,634 |

| | 2009 | 2008 |
|--|-------------|-------------|
| Amounts not yet reflected in net periodic postretirement benefit cost and included in unrestricted net assets: | | |
| Prior service benefit | \$ 1,488 | \$ 2,556 |
| Accumulated net actuarial loss | (3,856) | (6,253) |
| Amounts not yet recognized as a component of net periodic postretirement benefit cost | (2,368) | (3,697) |
| Accumulated net periodic postretirement benefit cost | (19,548) | (18,937) |
| Net amount recognized | \$ (21,916) | \$ (22,634) |

| | 2009 | 2008 |
|--|-------------|-------------|
| Sources of change in unrestricted net assets: | | |
| Net gain arising during the year | \$ 1,971 | \$ 2,061 |
| Amortizations: | | |
| Net actuarial loss | 391 | 604 |
| Prior service benefit | (847) | (852) |
| Total unrestricted net asset gain recognized during the year | \$ 1,515 | \$ 1,813 |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Net Periodic Postretirement Benefit Cost

Components of net periodic postretirement benefit cost are as follows for the years ended September 30:

| | <u>2009</u> | <u>2008</u> |
|--|-----------------|-----------------|
| Service cost | \$ 483 | \$ 567 |
| Interest cost | 1,546 | 1,505 |
| Amortization of prior service benefit | (847) | (852) |
| Amortization of net actuarial loss | <u>391</u> | <u>594</u> |
| Net periodic postretirement benefit cost | <u>\$ 1,573</u> | <u>\$ 1,814</u> |

The following weighted average assumptions were used by the plan's actuary to determine net periodic postretirement benefit cost and benefit obligations:

| | <u>2009</u> | <u>2008</u> |
|--|-------------|-------------|
| Discount rate for benefit obligations | 5.74% | 6.92% |
| Discount rate for net periodic postretirement benefit cost | 6.92 | 6.25 |

Assumed Health Care Cost Trend Rates at September 30:

| | <u>2009</u> | <u>2008</u> |
|--|-------------|-------------|
| Health care cost trend rate assumed for next year | 9% | 9% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 5% | 5% |
| Year that the rate reaches the ultimate trend rate | 2015 | 2015 |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Assumed health care cost trend rates have a significant effect on the amounts reported. A one-percentage-point increase in assumed health care cost trend rates would have the following effects as of September 30, 2009:

| | 1-Percentage- Point Increase | 1-Percentage- Point Decrease |
|---|---|---|
| Effect on total of service cost and interest cost | \$ 163 | \$ (146) |
| Effect on accumulated postretirement benefit obligation | 1,623 | (1,465) |

Expected Cash Flows

Information about the expected cash flows for the postretirement benefit plan follows:

Expected benefit payments:

| | |
|-------------------|----------|
| 2010 | \$ 1,348 |
| 2011 | 1,636 |
| 2012 | 1,733 |
| 2013 | 1,925 |
| 2014 | 2,021 |
| 2015 through 2019 | 10,877 |

(9) Patient Service Revenue and Related Reimbursement

A major portion of the Hospital's revenue is received from third-party payors. The following is an approximate percentage breakdown of gross patient service revenue by payor type for the years ended September 30:

| | 2009 | 2008 |
|---------------------------------|-------------|-------------|
| Medicare and Senior Care | 35% | 35% |
| Blue Cross | 20 | 20 |
| Medicaid and RIte Care | 19 | 19 |
| Managed care | 13 | 13 |
| Commercial, self-pay, and other | 13 | 13 |
| | 100% | 100% |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(9) Patient Service Revenue and Related Reimbursement (continued)

The Hospital grants credit to patients, most of whom are local residents. The Hospital generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross, managed care, and commercial insurance policies).

Cost reports filed annually with third-party payors are subject to audit prior to final settlement. The 2009 cost reports have not been filed and, therefore, not settled with either Medicare or Medicaid. In addition, the Medicare cost reports for 2006 through 2008 and the Medicaid cost reports for 2005 through 2008 have not been settled.

Regulations in effect require annual settlements based upon cost reports filed by the Hospital. These settlements are estimated and recorded in the accompanying consolidated financial statements. Changes in these estimates are reflected in the consolidated financial statements in the year in which they occur. Net patient service revenue in the accompanying consolidated statements of operations and changes in net assets was increased by \$2,243 and \$4,771 in 2009 and 2008, respectively, to reflect changes in the estimated settlements for certain prior years.

Revenues from Medicare and Medicaid programs accounted for approximately 35% and 19%, respectively, of the Hospital's gross patient service revenue for the year ended September 30, 2009. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations. The Hospital is responding to a recent investigation by the United States Department of Health and Human Services, Office of the Inspector General, dealing with the medical necessity of a limited number of Medicare inpatient claims. It is not possible to state at this time whether and to what extent liability will be imposed or a settlement will be reached. While the Hospital intends to continue to defend the matter vigorously, the Civil False Claims Act (the Act) contains provisions of the imposition of double and treble damages and civil penalties upon finding that the Act was violated, which could result in material liability. Compliance with laws and regulations can be subject to future government review and interpretation as well as significant regulatory action; failure to comply with such laws and regulations can result in fines, penalties and exclusion from Medicare and Medicaid programs.

(10) Income Tax Status

The Hospital and its affiliates are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from Federal income taxes pursuant to Section 501 (a) of the Code.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(11) Long-Term Debt

Long-term debt consists of the following at September 30:

| | 2009 | 2008 |
|---|-------------|-------------|
| Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2010 through 2032 in annual amounts ranging from \$6,605 to \$15,020 at rates ranging from 4% to 5% (2006A Series—Lifespan Obligated Group) | \$ 151,444 | \$ 153,324 |
| Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2027 through 2039 in annual amounts ranging from \$1,870 to \$7,900 at rates ranging from 6.125% to 7% (2009A Series—Lifespan Obligated Group) | 72,441 | — |
| Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2010 through 2026 in annual amounts ranging from \$625 to \$14,705 at rates ranging from 5.3% to 5.75% (1996 Series—Lifespan Obligated Group) | 45,033 | 45,519 |
| Hospital Financing Revenue fixed rate serial and term bonds due August 15, 2010 through 2012 in annual amounts ranging from \$1,420 to \$1,595 at rates ranging from 5.75% to 6.375% (2002 Series—Lifespan Obligated Group) | 3,386 | 4,391 |
| Unamortized premium – 2006A Series | 5,558 | 6,109 |
| Unamortized premium – 2009A Series | 127 | — |
| Unamortized discount – 1996 and 2002 Series | (30) | (50) |
| | 277,959 | 209,293 |
| Less current portion | 6,851 | 3,371 |
| Long-term debt, excluding current portion | \$ 271,108 | \$ 205,922 |

The estimated fair value of the Hospital's long-term debt at September 30, 2009 amounts to \$276,993 and is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(11) Long-Term Debt (continued)

On July 8, 2008, the Board of Directors of Lifespan Corporation, acting as the sole member of Emma Pendleton Bradley Hospital (EPBH), adopted a resolution authorizing EPBH to become a member of the Lifespan Obligated Group. The EPBH Board of Trustees, as well as the Boards of the Hospital and TMH, also authorized related resolutions.

On March 30, 2009, Rhode Island Health and Educational Building Corporation (RIHEBC) issued, on behalf of the Lifespan Obligated Group, which consists of the Hospital, TMH, EPBH, Rhode Island Hospital Foundation (RIHF) and The Miriam Hospital Foundation (TMHF), \$114,985 of tax-exempt bonds (the 2009A Bonds) for the purposes of financing the acquisition, construction, renovation, expansion and equipping of certain hospital and related health care facilities owned and operated by the Hospital, TMH and EPBH (the Obligated Group Hospitals), including the expansion, construction, renovation, equipping and furnishing of a two-story addition to EPBH's existing building and the renovation of vacated space in the existing building.

The above outstanding 2009 Hospital Financing Revenue Bonds (Lifespan Obligated Group—the Hospital, TMH, EPBH, RIHF and TMHF) are secured by a pledge of the gross receipts of the Obligated Group Hospitals and by mortgage liens on the Hospital's and TMH's real property and all buildings, structures and improvements thereon. The Obligated Group Hospitals, RIHF and TMHF are jointly and severally liable for repayment of the 2009A Bonds, recorded directly by the Obligated Group Hospitals as follows:

| | |
|--------------|-------------------|
| The Hospital | \$ 72,441 |
| TMH | 19,547 |
| EPBH | <u>22,997</u> |
| Total | \$ <u>114,985</u> |

Payment of the principal amount of and interest on \$64,825 of the 2009A Bonds when due is guaranteed by a financial guaranty insurance policy issued by Assured Guaranty Corp.

On February 14, 2006, Rhode Island Health and Educational Building Corporation (RIHEBC) issued, on behalf of the Lifespan Obligated Group, \$192,135 of tax-exempt bonds (the 2006A Bonds) for the purpose of refunding \$123,405 and \$65,315 of the Lifespan Obligated Group's 1996 Bonds and 2002 Bonds, respectively. The advance refundings were allocated as follows:

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(11) Long-Term Debt (continued)

| | <u>1996 Bonds</u> | <u>2002 Bonds</u> |
|--------------|-----------------------|-----------------------|
| The Hospital | \$ 101,809 | \$ 48,986 |
| TMH | <u>21,596</u> | <u>16,329</u> |
| Total | <u>\$ 123,405</u> | <u>\$ 65,315</u> |

On September 12, 2006, the Board of Directors of Lifespan Corporation, acting as the sole member of each of The Miriam Hospital Foundation and Rhode Island Hospital Foundation (the Foundations), adopted resolutions authorizing the Foundations to become members of the Lifespan Obligated Group. The Boards of Trustees of each of the Foundations, as well as the then existing members of the Lifespan Obligated Group, the Hospital and TMH, previously authorized related resolutions. The effective date for such change was October 1, 2006.

The above outstanding 2006 Hospital Financing Revenue Bonds (Lifespan Obligated Group—the Hospital, TMH, EPBH and the Foundations) are secured by a pledge of the gross receipts of the Hospital and TMH and by mortgage liens on the Hospital's and TMH's real property and all buildings, structures and improvements thereon. The Obligated Group Hospitals and the Foundations are jointly and severally liable for repayment of the 2006A Bonds, \$151,444 and \$38,336 of which has been recorded directly by the Hospital and TMH, respectively. Payment of the principal and interest on the 2006A Bonds when due is guaranteed by a financial guaranty insurance policy issued by Assured Guaranty Corp.

On July 9, 2002, RIHEBC issued, on behalf of the Lifespan Obligated Group, \$78,000 of tax-exempt bonds (the 2002 Bonds) to finance routine capital expenditures of the Hospital and TMH, renovations of the RIH emergency department and construction and equipping of a cancer center on the campus of RIH.

The above outstanding 2002 Hospital Financing Revenue Bonds (Lifespan Obligated Group—the Hospital, TMH, EPBH and the Foundations) are secured by mortgage liens on the Hospital's and TMH's real property and all buildings, structures and improvements thereon. The Obligated Group Hospitals and the Foundations are jointly and severally liable for repayment of the 2002 Bonds, \$3,386 and \$1,129 of which has been recorded directly by the Hospital and TMH, respectively.

On December 1, 1996, RIHEBC issued, on behalf of the Lifespan Obligated Group, \$214,585 of tax-exempt bonds (the 1996 Bonds), to finance portions of Lifespan's, the Hospital's and TMH's 1996, 1997, 1998 and 1999 expenditures for routine capital equipment and facility renovation/replacement, and to advance refund \$8,455 of TMH 1989 Series A bonds, \$1,900 of TMH 1992 Series A bonds and \$10,065 of TMH 1992 Series B bonds.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(11) Long-Term Debt (continued)

The above outstanding 1996 Hospital Financing Revenue Bonds (Lifespan Obligated Group—the Hospital, TMH, EPBH and the Foundations) are secured by a pledge of the gross receipts of the Hospital and TMH. The Obligated Group Hospitals and the Foundations are jointly and severally liable for repayment of the 1996 Bonds, \$45,033 and \$9,552 of which has been recorded directly by the Hospital and TMH, respectively. Payment of the principal and interest on the 1996 Bonds when due is guaranteed by a financial guaranty insurance policy issued by MBIA Insurance Corporation.

Under the terms of the 2009, 2006, 2002 and 1996 Bonds, the Obligated Group Hospitals are required to satisfy certain measures of financial performance as long as the bonds are outstanding. At September 30, 2009, management believes the Obligated Group Hospitals were in compliance with all covenants of the bonds.

The Hospital's aggregate maturities of long-term debt for the five fiscal years ending in September 2014 are as follows: 2010, \$6,851; 2011, \$7,151; 2012, \$7,523; 2013, \$7,987; and 2014, \$8,396.

Agreements underlying the various Hospital Financing Revenue Bonds require that the Obligated Group Hospitals maintain certain trustee-held funds, included with assets limited as to use in the consolidated statements of financial position, as follows:

Project Fund — The Obligated Group Hospitals are required to apply monies in the Project Fund to pay the costs of debt issuance, facility renovation/replacement, and routine capital equipment.

Bond Funds — The Obligated Group Hospitals are required to make periodic deposits to the trustee sufficient to provide sinking funds for the payment of principal and interest to bondholders when due.

Debt Service Reserve Funds — The Obligated Group Hospitals are required to apply monies in the Debt Service Reserve Funds to remedy deficiencies in the Bond Funds, if any.

The Hospital's trustee-held funds at September 30 are summarized as follows:

| | 2009 | 2008 |
|--|-----------|----------|
| Project Fund – 2009 Series | \$ 39,450 | \$ — |
| Bond Funds | 2 | 847 |
| Debt Service Reserve Funds – 2009 Series | 7,246 | — |
| Debt Service Reserve Funds – 2002 Series | 390 | 389 |
| Total | \$ 47,088 | \$ 1,236 |

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(12) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30:

| | 2009 | 2008 |
|--|-------------|-------------|
| General health care service activities | \$ 141,656 | \$ 72,259 |
| Research | 50,666 | 33,817 |
| Interest in net assets of Rhode Island Hospital Foundation | 15,056 | 14,353 |
| Total | \$ 207,378 | \$ 120,429 |

Permanently restricted net assets are restricted in perpetuity at September 30, the income from which is expendable to support the following:

| | 2009 | 2008 |
|--|-------------|-------------|
| General health care service activities | \$ 32,905 | \$ 113,017 |
| Research | 4,995 | 22,523 |
| Interest in net assets of Rhode Island Hospital Foundation | 19,114 | 23,386 |
| Total | \$ 57,014 | \$ 158,926 |

(13) Leases

The Hospital leases building space and equipment under various noncancelable operating lease agreements. Future minimum lease payments, by year and in the aggregate, under noncancelable operating leases with terms of one year or more consist of the following at September 30, 2009:

| Year Ending September 30: | Amount |
|------------------------------|---------------|
| 2010 | \$ 5,726 |
| 2011 | 4,256 |
| 2012 | 3,742 |
| 2013 | 3,319 |
| 2014 | 2,201 |
| Total minimum lease payments | \$ 19,244 |

Rental expense, including rentals under leases with terms of less than one year, for the years ended September 30, 2009 and 2008 was \$8,698 and \$7,938, respectively.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(14) Concentrations of Credit Risk

Financial instruments which potentially subject the Hospital to concentrations of credit risk consist primarily of accounts receivable and certain investments. The risk associated with temporary cash investments is mitigated by the fact that the investments are placed with what management believes are high credit quality financial institutions. Investments, which include government and agency obligations, stocks, and corporate bonds, are not concentrated in any corporation or industry.

The Hospital receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payors, including Medicare, Blue Cross, Medicaid, and various managed care entities. The Hospital has not historically incurred any significant concentrated credit losses in the normal course of business.

(15) Malpractice and Other Litigation

Professional Liability/Medical Malpractice and General Liability

Professional liability/medical malpractice coverage for the Hospital is supplied on a claims-made basis by Rhode Island Sound Enterprises Insurance Co. Ltd. (RISE), Lifespan's affiliated captive insurance company, which underwrites the medical malpractice risk of the Hospital (including the Hospital's contractual commitment to indemnify certain eligible non-employed physicians). The adequacy of the coverage provided and the funding levels are reviewed annually by independent actuaries and consultants. The professional liability/medical malpractice insurance provided by RISE has liability limits of \$4,000 per claim with no annual aggregate. RISE provides a second layer of coverage which has limits of an additional \$2,000 per claim with a \$2,000 annual aggregate. In addition, commercial umbrella excess insurance has been obtained by Lifespan to increase the professional liability limits to \$22,000 per claim. Also covered under the Hospital's professional liability/medical malpractice policy are 514 non-employed physicians. Each of these physicians is provided with a \$2,000 indemnification per claim and a \$6,000 annual indemnification aggregate.

The Hospital or its indemnified physicians have been named as defendants in a number of pending actions seeking damages for alleged general or medical malpractice liability. In the opinion of management, any liability and legal defense costs resulting from these actions will be within the limits of the Hospital's malpractice insurance coverage provided by RISE and/or commercial excess carriers.

General liability coverage is provided to the Hospital by RISE amounting to \$4,000 per claim and \$4,000 in the annual aggregate. Commercial excess liability insurance has been obtained by Lifespan which provides aggregate general liability coverage of \$80,000.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(15) Malpractice and Other Litigation

Workers' Compensation

The Hospital has incurred a number of workers' compensation claims and, in the opinion of management, the liability of the Hospital will be within the limits of the assets of Lifespan's workers' compensation self-insurance trust fund.

Other Litigation

The Hospital is also involved in a number of miscellaneous suits and general liability suits arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations.

(16) Related-Party Transactions

The Hospital rents space and provides laundry and linen services to affiliates. Included in the Hospital's other revenue in the consolidated statements of operations and changes in net assets are the following amounts resulting from transactions with affiliates for the years ended September 30:

| | <u>2009</u> | <u>2008</u> |
|---------------------------------------|-----------------|-----------------|
| Rental income | \$ 3,411 | \$ 3,420 |
| Services rendered – laundry and linen | <u>1,578</u> | <u>1,578</u> |
| Total | <u>\$ 4,989</u> | <u>\$ 4,998</u> |

The Hospital was charged a management fee by Lifespan of \$68,189 and \$65,089 in 2009 and 2008, respectively, representing approximately 65% and 61%, respectively, of Lifespan's operating expenses. Lifespan provides information services, human resources, financial, and various other support services to the Hospital.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(16) Related-Party Transactions (continued)

Included in other receivables and other accrued expenses in the consolidated statements of financial position are the following amounts due from (to) certain related entities at September 30:

| | <u>2009</u> | <u>2008</u> |
|----------------------------------|-----------------|-------------------|
| Other receivables: | | |
| TMH | \$ 941 | \$ 3,189 |
| Newport Hospital | — | 231 |
| Emma Pendleton Bradley Hospital | 113 | 136 |
| Rhode Island Hospital Foundation | <u>27</u> | <u>—</u> |
| Total | <u>\$ 1,081</u> | <u>\$ 3,556</u> |
| Other accrued expenses: | | |
| Lifespan | \$ (296) | \$ (8,740) |
| Newport Hospital | <u>(208)</u> | <u>—</u> |
| Total | <u>\$ (504)</u> | <u>\$ (8,740)</u> |

During the years ended September 30, 2009 and 2008, the Hospital received temporarily restricted net asset transfers from Rhode Island Hospital Foundation (the Foundation) amounting to \$6,033 and \$5,704, respectively.

The Foundation, whose sole corporate member is Lifespan Corporation, was established to engage in philanthropic activities to support the mission and purposes of Lifespan and the Hospital. Funds are distributed to the Hospital when purpose restrictions stipulated by donors are accomplished, or as determined by the combined Board of Trustees of the Hospital and the Foundation. A summary of the Foundation's assets, liabilities, net assets, deficiency of revenues over expenses, and changes in net assets follows. The Hospital's interest in the net assets of the Foundation is reported as a noncurrent asset in the consolidated statements of financial position.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(16) Related-Party Transactions (continued)

| | <u>2009</u> | <u>2008</u> |
|--|------------------|------------------|
| Assets, principally assets limited as to use | \$ <u>42,699</u> | \$ <u>50,267</u> |
| Liabilities | \$ 147 | \$ 456 |
| Unrestricted net assets | 8,382 | 12,072 |
| Temporarily restricted net assets | 15,056 | 14,353 |
| Permanently restricted net assets | <u>19,114</u> | <u>23,386</u> |
| Total liabilities and net assets | \$ <u>42,699</u> | \$ <u>50,267</u> |
| | | |
| Total unrestricted revenues, gains and other support | \$ 1,437 | \$ 2,075 |
| Total expenses | <u>4,857</u> | <u>5,027</u> |
| Deficiency of revenues over expenses | (3,420) | (2,952) |
| Other decreases in unrestricted net assets | (270) | (7,958) |
| Unrestricted net assets, beginning of year | <u>12,072</u> | <u>22,982</u> |
| Unrestricted net assets, end of year | \$ <u>8,382</u> | \$ <u>12,072</u> |
| | | |
| Increase (decrease) in temporarily restricted net assets | \$ 703 | \$ (2,949) |
| Temporarily restricted net assets, beginning of year | <u>14,353</u> | <u>17,302</u> |
| Temporarily restricted net assets, end of year | \$ <u>15,056</u> | \$ <u>14,353</u> |
| | | |
| (Decrease) increase in permanently restricted net assets | \$ (4,272) | \$ 1,220 |
| Permanently restricted net assets, beginning of year | <u>23,386</u> | <u>22,166</u> |
| Permanently restricted net assets, end of year | \$ <u>19,114</u> | \$ <u>23,386</u> |

Liabilities of the Foundation include \$27 payable to the Hospital at the end of 2009. This amount was paid after the end of the year.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2009 and 2008

(In thousands)

(17) Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows for the years ended September 30:

| | <u>2009</u> | <u>2008</u> |
|----------------------------------|-------------------|-------------------|
| Health care services | \$ 790,425 | \$ 752,464 |
| Research | 54,437 | 59,775 |
| General and administrative: | | |
| Depreciation and amortization | 32,698 | 31,024 |
| Interest | 12,094 | 9,707 |
| Other | 74,264 | 70,507 |
| Total general and administrative | <u>119,056</u> | <u>111,238</u> |
| | <u>\$ 963,918</u> | <u>\$ 923,477</u> |

(18) Combination of RIH and TMH

On July 21, 2009, Lifespan announced its intention to combine the Hospital and TMH into a single hospital with two campuses. Rhode Island Hospital Foundation and The Miriam Hospital Foundation will remain as separate entities. The hospitals do not expect the elimination of services or a significant loss of jobs. The plan will be subject to applicable State regulatory approvals.