

**SPECTRUM HEALTH INC. AND AFFILIATES**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
September 30, 2010 and 2009

SPECTRUM HEALTH INC. AND AFFILIATES

CONSOLIDATED  
FINANCIAL STATEMENTS  
September 30, 2010 and 2009

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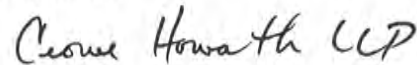
## REPORT OF INDEPENDENT AUDITORS

Board of Directors  
Spectrum Health Inc. and Affiliates  
West Palm Beach, Florida

We have audited the accompanying consolidated balance sheets of Spectrum Health Inc. and Affiliates (the "Organization") as of September 30, 2010 and 2009, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Spectrum Health Inc. and Affiliates as of September 30, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



Crowe Horwath LLP

South Bend, Indiana  
December 14, 2010

SPECTRUM HEALTH INC. AND AFFILIATES  
CONSOLIDATED BALANCE SHEETS  
September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 11,622,166	\$ 6,210,744
Patient accounts receivable, net	6,871,191	8,397,357
Bequests receivable	180,866	405,438
Other current assets	<u>1,538,090</u>	<u>1,640,460</u>
Total current assets	20,212,313	16,653,999
Investments	85,222,640	78,465,532
Interest in net assets of Hospice Foundation of Palm Beach County, Inc. ("HFPBC")	16,333,636	15,511,714
Property and equipment, net	22,455,761	20,927,209
Goodwill, net	278,968	334,759
Deferred financing costs, net	<u>166,006</u>	<u>173,914</u>
	<u>\$ 144,669,324</u>	<u>\$ 132,067,127</u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities		
Accounts payable	\$ 565,690	\$ 634,588
Accrued payroll and benefits	5,116,813	4,962,036
Accrued expenses and other current liabilities	<u>2,903,674</u>	<u>2,827,134</u>
Total current liabilities	8,586,177	8,423,758
Long-term debt	<u>12,000,000</u>	<u>12,000,000</u>
	<u>20,586,177</u>	<u>20,423,758</u>
Net assets		
Unrestricted		
Undesignated	31,877,792	20,861,738
Board designated	<u>70,000,000</u>	<u>70,000,000</u>
Total unrestricted net assets	<u>101,877,792</u>	<u>90,861,738</u>
Temporarily restricted	19,505,355	18,081,631
Permanently restricted	<u>2,700,000</u>	<u>2,700,000</u>
Total net assets	<u>124,083,147</u>	<u>111,643,369</u>
	<u>\$ 144,669,324</u>	<u>\$ 132,067,127</u>

See accompanying notes to consolidated financial statements.

SPECTRUM HEALTH INC. AND AFFILIATES  
CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS  
Years ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>Unrestricted net assets</b>		
Revenues and other support		
Net patient service revenues	\$ 85,201,324	\$ 84,449,265
Resale of donated merchandise	1,190,275	1,169,442
Contributions, memorials, and bequests	4,000,919	6,804,926
Net assets released from restrictions	<u>210,519</u>	<u>780,827</u>
	90,603,037	93,204,460
Expenses		
Payroll and related expenses	56,381,041	56,071,489
Patient related expenses	13,135,389	12,837,803
Occupancy and equipment expenses	13,240,653	12,832,558
Other operating expenses	<u>3,715,147</u>	<u>3,546,748</u>
	<u>86,472,230</u>	<u>85,288,598</u>
Change in net assets from operations	4,130,807	7,915,862
Nonoperating revenues and expenses		
Investment income, net of fees of \$689,261 in 2010 and \$553,512 in 2009	181,633	21,609
Net realized and unrealized gain (loss) on investments	6,737,823	(1,753,127)
Other non operating revenues	59,320	98,890
Bond interest and other fees	<u>(93,529)</u>	<u>(158,262)</u>
	<u>6,885,247</u>	<u>(1,790,890)</u>
Change in unrestricted net assets	11,016,054	6,124,972
<b>Temporarily restricted net assets</b>		
Grants and contributions	812,321	911,038
Change in interest in net assets of HFPBC	821,922	(784,981)
Net assets released from restrictions	<u>(210,519)</u>	<u>(780,827)</u>
Change in temporarily restricted net assets	<u>1,423,724</u>	<u>(654,770)</u>
<b>Change in net assets</b>	12,439,778	5,470,202
Net assets at beginning of year	<u>111,643,369</u>	<u>106,173,167</u>
<b>Net assets at end of year</b>	<u>\$ 124,083,147</u>	<u>\$ 111,643,369</u>

See accompanying notes to consolidated financial statements.

SPECTRUM HEALTH INC. AND AFFILIATES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>Cash flows from operating activities</b>		
Change in net assets	\$ 12,439,778	\$ 5,470,202
Adjustments to reconcile change in net assets to net cash from operating activities		
Depreciation and amortization	2,383,498	2,053,026
Net realized and unrealized (gain) loss on investments	(6,737,823)	1,753,127
Contribution of property and equipment	(107,686)	-
Loss on termination of projects in progress	-	13,312
Provision for uncollectible accounts	2,201,804	2,705,132
Change in interest in net assets of HFPBC	(821,922)	784,981
Donated property	-	(274,000)
Changes in assets and liabilities		
Patient accounts receivable	(675,638)	(4,100,025)
Bequests receivable	224,572	(349,188)
Other current assets	102,370	(439,864)
Accounts payable	(68,898)	77,188
Accrued payroll and benefits	154,777	1,266,983
Accrued expenses and other current liabilities	<u>76,540</u>	<u>190,695</u>
Net cash from operating activities	9,171,372	9,151,569
 <b>Cash flows from investing activities</b>		
Proceeds from sales of investments	29,789,706	35,605,330
Purchases of investments	(29,808,991)	(40,015,223)
Purchases of property and equipment	<u>(3,740,665)</u>	<u>(2,499,010)</u>
Net cash from investing activities	(3,759,950)	(6,908,903)
 <b>Cash flows from financing activities</b>		
Principal payments on long-term debt	<u>-</u>	<u>(121,919)</u>
Net cash from financing activities	<u>-</u>	<u>(121,919)</u>
 Net change in cash and cash equivalents	5,411,422	2,120,747
 Cash and cash equivalents at beginning of year	<u>6,210,744</u>	<u>4,089,997</u>
 <b>Cash and cash equivalents at end of year</b>	<u>\$ 11,622,166</u>	<u>\$ 6,210,744</u>
 <b>Supplemental disclosures of cash flow information</b>		
Cash paid for interest	\$ 39,248	\$ 148,133

See accompanying notes to consolidated financial statements.

SPECTRUM HEALTH INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2010 and 2009

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**NOTE 1 - NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations: Spectrum Health, Inc. ("Spectrum"), is a non-stock, not-for-profit corporation organized in Florida. Spectrum is a holding company and sole member for the following affiliates:

- Hospice of Palm Beach County, Inc. ("HPBC")
- The Medical Store of Palm Beach County, Inc. ("TMS")
- Hospice of Palm Beach County Foundation, Inc. ("HPBC Foundation")
- Hospice Partners On Call, Inc. ("HPOC")

HPBC provides a coordinated, comprehensive program including physical, psychosocial, spiritual, music, and bereavement support to terminally ill patients and their families in Palm Beach County, Florida.

In 2009, TMS provided durable medical equipment and medical supplies to HPBC, other health care providers, and to individuals through contracts and agreements with Medicare, Medicaid, and commercial insurance companies. TMS also sells and services rehabilitation equipment. The majority of the 2009 billings of TMS were to HPBC. In 2010, TMS was restructured to only include sales to outside parties. HPBC now maintains the equipment rental inventory and allocates third party cost of sales and other expenses to TMS.

HPBC Foundation provides fundraising, investment management, grants, and other support services to Spectrum Health, Inc. and its affiliates.

HPOC is a triage call center service that provides seamless telephone access to hospice trained professionals after hours. This service allows hospices that do not have a centralized, clinical based call center with triage capability to meet the evening and weekend needs of their patients and families.

Basis of Presentation: The consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP")

Basis of Consolidation: The accompanying consolidated financial statements include the accounts of Spectrum Health Inc. and Affiliates (collectively referred to as the "Organization"). All inter-organization accounts and transactions have been eliminated in consolidation.

Financial Statement Presentation: The financial statements report the changes in and totals of each net asset class based on the existence of donor restrictions, as applicable. Net assets are classified as unrestricted, temporarily restricted, or permanently restricted and are detailed as follows:

Unrestricted net assets represent the part of the net assets of the Organization that is neither permanently restricted nor temporarily restricted by donor-imposed stipulations.

Temporarily restricted net assets represent the part of the net assets of the Organization resulting from contributions and other inflows of assets whose use by the Organization is limited by donor-imposed stipulations that either expire by the passage of time or by actions of the Organization. For the years ended September 30, 2010 and 2009, the temporarily restricted net assets are primarily restricted for patient-related care and therapeutic activities, in addition to the interest in net assets of HFPBC.

SPECTRUM HEALTH INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2010 and 2009

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**NOTE 1 - NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Permanently restricted net assets represent the part of the net assets of the Organization resulting from contributions and other inflows of assets whose use by the Organization is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Organization. For the years ended September 30, 2010 and 2009, the permanently restricted net assets are invested in perpetuity for the purpose of generating income that is available for supporting the operations of HPBC.

Use of Estimates: The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Areas where significant estimates are used in the accompanying consolidated financial statements include the allowance for uncollectible accounts and bad debt expense, fair values of investment securities and other financial instruments, and estimated third-party liabilities. These estimates and assumptions may change in the near future resulting in different actual results.

Cash and Cash Equivalents: Cash and cash equivalents consist of bank deposits in accounts that are either interest-bearing and federally insured up to \$250,000 or non-interest bearing and fully guaranteed by the federal government. Additionally, for purposes of the consolidated statements of cash flows, the Organization considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Accounts Receivable: The accounts receivable balance represents the unpaid amounts billed to patients and third-party payors. Contractual adjustments, discounts, and an allowance for uncollectible accounts are recorded to report receivables at net realizable value. Past due receivables are determined based on contractual terms. The Organization does not accrue interest on any of its accounts receivable.

Allowance for Uncollectible Accounts: The allowance for uncollectible accounts is determined by management based on the Organization's historical losses, specific patient circumstances, and general economic conditions. Periodically, management reviews accounts receivable and adjusts the allowance based on current circumstances and charges off uncollectible receivables when all attempts to collect have failed in accordance with the Organization's collection policy. Management believes the allowance of \$1,468,592 and \$1,109,564 as of September 30, 2010 and 2009, respectively, is adequate to cover potential losses from uncollectible accounts.

Investments: All investments are valued at their fair values in the consolidated balance sheets. Unrealized gains and losses are included in the change in net assets. See Notes 3 and 14 for additional information on the nature of the Organization's investments.

Interest in net assets of HFPBC: Interest in net assets of HFPBC is valued at fair value in the balance sheets. See Note 13 for additional information.

Property and Equipment: Property and equipment are stated at cost or, if donated to the Organization, at fair value on the date of acquisition. Additions and improvements over \$5,000 are capitalized; expenditures for routine maintenance are charged to operations. Depreciation is provided over the estimated useful lives of the various classes of assets which range from three to thirty years and is computed on the straight-line method.

SPECTRUM HEALTH INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2010 and 2009

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**NOTE 1 - NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Gifts of long-lived assets such as land, buildings, and equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets are to be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash and other assets that must be used to acquire long-lived assets are reported as temporarily restricted support. Absent explicit donor stipulations about how long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

The cost of property and equipment sold or otherwise disposed of and the accumulated depreciation applicable thereto are eliminated from the accounts, and any resulting gain or loss is reflected in the consolidated financial statements in the period of disposition.

Impairment of Long-Lived Assets: On an ongoing basis, the Organization reviews long-lived assets for impairment whenever events or circumstances indicate that the carrying amounts may be overstated. The Organization recognizes impairment losses if the undiscounted cash flows expected to be generated by the asset are less than the carrying value of the related asset. The impairment loss adjusts the assets to fair value. As of September 30, 2010 and 2009, management believes that no impairments exist.

Goodwill: Goodwill represents the excess of the purchase price over the fair value of net assets of TMS, and is being amortized on a straight-line basis over 10 years. Recoverability is reviewed annually or sooner if events or changes in circumstances indicate that the carrying amount may exceed fair value.

Deferred Financing Costs: Costs associated with the issuance of the bonds have been deferred and are being amortized on the straight-line method, which approximates the effective interest method, over the life of the related debt.

Net Patient Service Revenues: Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

Hospice organizations are subject to two specific payment limit caps under the Medicare program. One limit relates to inpatient care days that exceed 20% of the total days of hospice care provided for the year. HPBC did not exceed the 20% cap related to inpatient days in 2010 and 2009. The second limit relates to an aggregate Medicare reimbursement cap calculated by the Medicare fiscal intermediary. HPBC did not exceed the Medicare reimbursement cap for the years ended September 30, 2010 and 2009.

Charity Care: HPBC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because HPBC does not expect payment, charges are not included in the net patient service revenues. Charity care is measured using HPBC's established rates and amounted to \$1,272,520 in 2010 and \$1,397,255 in 2009.

Resale of Donated Merchandise: The Organization operates resale shops that sell primarily donated merchandise. The fair value of the donated merchandise sold approximates the revenue generated from its sale.

Contributions: Contributions received and unconditional promises to give are recorded as unrestricted, temporarily restricted, or permanently restricted revenue depending on the existence of donor restrictions and the nature of such restrictions, if they exist. Conditional promises to give are recognized in the consolidated statements of operations and changes in net assets only when the conditions on which they depend are substantially met and the promises become unconditional.

SPECTRUM HEALTH INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2010 and 2009

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**NOTE 1 - NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES** (Continued)

When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

Donor restricted gifts that are received for which their restricted purpose is met during the same year are initially recorded as temporarily restricted net assets and then reported as net assets released from restrictions and reclassified as unrestricted net assets.

HPBC Foundation actively solicits contributions on behalf of Spectrum and its affiliates.

Special Events: The following amounts relate to special events that are on-going and major activities of the Organization.

	<u>2010</u>	<u>2009</u>
Revenue	\$ 634,482	\$ 534,495
Expense	<u>271,627</u>	<u>257,136</u>
Net proceeds	<u>\$ 362,855</u>	<u>\$ 277,359</u>

Revenue is included in contributions, memorials, and bequests, and expenses are included in other operating expenses in the statements of operations and changes in net assets.

Fair Value of Financial Instruments: The Organization's carrying amount for its financial instruments, which include cash, accounts receivable, interest in net assets of HFPBC, investments, accounts payable, and long-term debt, approximates fair value.

Income Taxes: Spectrum and the affiliate organizations are exempt from income taxes on income from related activities under Section 501(c)(3) of the U.S. Internal Revenue Code and corresponding state tax law. Accordingly, no provision has been made for federal or state income taxes.

U.S. GAAP requires that a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

Due to its tax-exempt status, Spectrum and its affiliates are not subject to U.S. federal income tax or state income tax. The applicable Forms 990 have not been subject to examination by the Internal Revenue Service or the state of Florida for the last three years. The Organization does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months. The Organization recognizes interest and/or penalties related to income tax matters in income tax expense. The Organization did not have any amounts accrued for interest and penalties at September 30, 2010 and 2009.

Reclassifications: Certain reclassifications have been made to present last year's consolidated financial statements on a basis comparable to the current year's consolidated financial statements. These reclassifications had no effect on total net assets or the change in net assets.

SPECTRUM HEALTH INC. AND AFFILIATES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 September 30, 2010 and 2009

**NOTE 1 - NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Subsequent Events: Management has performed an analysis of the activities and transactions subsequent to September 30, 2010 to determine the need for any adjustments to and/or disclosures within the audited financial statements for the year ended September 30, 2010. Management has performed their analysis through December 14, 2010, which is the date the consolidated financial statements were issued.

**NOTE 2 - ACCOUNTS RECEIVABLE**

The Organization provides hospice and palliative care services, medicine, medical equipment, and medical supplies to patients, and does not require collateral or other security in providing these services. However, the Organization routinely obtains assignment of benefits payable under patients' health care insurance programs, plans, or policies. Since over 90% of the Organization's revenues come from Medicare and Medicaid, credit risk with respect to accounts receivable is limited. At September 30, 2010 and 2009, approximately 70% and 79%, respectively, of the Organization's accounts receivable are from Medicare and Medicaid.

At September 30, accounts receivable by payor category consists of the following:

	<u>2010</u>	<u>2009</u>
Medicare	\$ 2,912,030	\$ 3,346,998
Medicaid	2,921,597	4,195,937
Private insurance	2,242,064	1,838,820
Patients and others	<u>264,092</u>	<u>125,166</u>
	8,339,783	9,506,921
Less: Allowance for uncollectible accounts	<u>(1,468,592)</u>	<u>(1,109,564)</u>
	<u>\$ 6,871,191</u>	<u>\$ 8,397,357</u>

**NOTE 3 - INVESTMENTS**

The following are the major categories of investments held by the Organization at September 30:

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	\$ 1,504,432	\$ 7,099,126
Equity securities	3,710,753	3,395,496
Equity mutual funds	30,764,539	25,506,920
Fixed income mutual funds	26,306,803	18,776,492
Government debt securities	-	202,148
Real assets mutual funds	6,411,268	7,458,430
Fund of funds	<u>16,524,845</u>	<u>16,026,920</u>
	<u>\$ 85,222,640</u>	<u>\$ 78,465,532</u>

Investments are carried at fair values, as disclosed in Note 14. Investment securities are exposed to various risks, such as interest rate, market, and credit. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term would result in material changes in the fair value of investments and net assets of the Organization.

SPECTRUM HEALTH INC. AND AFFILIATES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 September 30, 2010 and 2009

**NOTE 4 - PROPERTY AND EQUIPMENT**

The Organization's property and equipment at September 30 is as follows:

	<u>2010</u>	<u>2009</u>
Land and improvements	\$ 2,191,915	\$ 2,191,915
Buildings and improvements	18,558,544	18,181,674
Leasehold improvements	2,093,033	1,522,877
Furniture and equipment	6,251,553	4,878,441
Technology costs	7,171,921	5,985,243
Equipment held for rent	831,114	775,223
Vehicles	578,022	519,511
Projects in progress	<u>781,124</u>	<u>1,145,538</u>
	38,457,226	35,200,422
Less: Accumulated depreciation	<u>(16,001,465)</u>	<u>(14,273,213)</u>
	<u>\$ 22,455,761</u>	<u>\$ 20,927,209</u>

Depreciation expense for the years ended September 30, 2010 and 2009 was \$2,319,799 and \$1,989,326, respectively.

Projects in progress at September 30, 2010 primarily relate to new patient management and electronic medical record software. The Organization has estimated total capitalized costs of approximately \$3,600,000 (not including future annual hosting and maintenance fees) to purchase the initial licenses and implement the software, approximately \$470,000 of which is included in projects in progress at September 30, 2010. Additional operating expenses of approximately \$1,200,000 are estimated for conversion and training purposes. Projects in progress at September 30, 2009 primarily relate to inpatient unit renovations and software implementation projects.

Technology costs include the costs incurred to develop Organization's proprietary patient services and billing software as well as purchased software and hardware. Capitalized software and hardware costs include amounts paid to vendors, fees to third parties related to implementation, and internal costs of Organization's personnel directly related to implementation. The proprietary patient services and billing software will be fully replaced by the new patient management software in fiscal year 2012.

**NOTE 5 - LONG-TERM DEBT**

In December 2001, HPBC entered into a loan agreement with Palm Beach County, Florida relating to the issuance of \$12,000,000 in variable rate demand revenue bonds (Series 2001). The bonds were issued in connection with a project to expand HPBC's Gerstenberg Center facility. The entire bond issue is due October 1, 2031 and bears interest at prevailing market rates determined by the remarketing agent, reset every seven (7) days (effective average interest rates of 0.31% and 0.87% for fiscal years 2010 and 2009, respectively). In the event the remarketing agent is unable to remarket the bonds, they become a demand note under the letter of credit and require repayment under the terms of the letter of credit.

The Series 2001 Bonds are secured by an irrevocable transferable letter of credit issued by The Northern Trust Company. The letter of credit expires on October 1, 2013, and contains a guarantee from Spectrum and HPBC Foundation.

SPECTRUM HEALTH INC. AND AFFILIATES  
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**NOTE 5 - LONG-TERM DEBT** (Continued)

The bonds contain covenants relating to ongoing operations and tax-exempt status. The Organization is in compliance with all financial covenants.

Interest expense was \$39,248 and \$108,158 for the years ended September 30, 2010 and 2009, respectively.

TMS had recorded an obligation to the prior owner relating to the purchase of the durable medical equipment assets. The balance was paid during the year ended September 30, 2009.

**NOTE 6 - NET ASSETS**

The Organization's net assets at September 30 are as follows:

	<u>2010</u>	<u>2009</u>
Undesignated	\$ 31,877,792	\$ 20,861,738
Board designated		
Operating reserves	50,000,000	50,000,000
Asset additions and replacements	5,000,000	10,000,000
Clinical systems replacement	5,000,000	-
Unfunded programs	7,000,000	7,000,000
Charity care	<u>3,000,000</u>	<u>3,000,000</u>
	<u>70,000,000</u>	<u>70,000,000</u>
Temporarily restricted	19,505,355	18,081,631
Permanently restricted	<u>2,700,000</u>	<u>2,700,000</u>
	<u>\$ 124,083,147</u>	<u>\$ 111,643,369</u>

**NOTE 7 - PATIENT SERVICE REVENUES**

Patient service revenues for the years ended September 30 are as follows:

	<u>2010</u>	<u>2009</u>
Government sources		
Medicare	\$ 76,697,891	\$ 76,396,780
Medicaid	<u>4,847,841</u>	<u>4,934,838</u>
	81,545,732	81,331,618
Other sources		
Insurance, private pay, and other third-parties	<u>5,857,396</u>	<u>5,822,779</u>
	87,403,128	87,154,397
Less: Allowances and charity care	<u>(2,201,804)</u>	<u>(2,705,132)</u>
	<u>\$ 85,201,324</u>	<u>\$ 84,449,265</u>

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SPECTRUM HEALTH INC. AND AFFILIATES  
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**NOTE 8 - PENSION PLAN**

The Organization maintains a non-contributory defined contribution pension plan covering substantially all of its full-time employees. The amounts contributed to the plan are five percent of eligible employees' gross wages. Total pension expense for 2010 and 2009 was \$1,934,666 and \$1,814,610, respectively.

**NOTE 9 - LEASES**

The Organization leases various patient care facilities, resale shops, and office space under operating leases that extend through February 2015. Total rent expense, included in occupancy and equipment expenses, amounted to \$5,447,358 in 2010 and \$5,273,688 in 2009.

Future minimum payments under the operating leases consist of the following:

2011	\$ 4,697,437
2012	3,355,427
2013	1,148,610
2014	1,121,673
2015	<u>987,807</u>
	<u>\$ 11,310,954</u>

**NOTE 10 - DONATED SERVICES**

The Organization has estimated that during 2010 and 2009, dedicated volunteers have donated hours of service as follows:

	<u>2010</u>	<u>2009</u>
Patient care services	12,407	10,749
Clerical and other services	<u>35,438</u>	<u>31,415</u>
	<u>\$ 47,845</u>	<u>\$ 42,164</u>

Because the above donated services do not meet the recognition criteria of U.S. GAAP, their estimated values have not been recognized in the statements of operations and changes in net assets.

**NOTE 11 - COMMITMENTS AND CONTINGENCIES**

In August 2010, HPBC was approved for expansion into Broward County by the State of Florida. The decision has been appealed by other hospice providers. HPBC is currently challenging the appeal. HPBC estimates that it will cost approximately \$2,000,000 to commence hospice services in Broward County. This amount includes staffing, administration, legal, consulting, and capital costs associated with the startup.

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**NOTE 12 - FUNCTIONAL EXPENSES**

Expenses related to providing hospice, palliative care, and medical equipment services as well as fundraising and resale activities for the years ended September 30 are as follows:

	<u>2010</u>	<u>2009</u>
Hospice and palliative care	\$ 71,316,937	\$ 68,428,398
General and administrative	11,745,040	11,153,951
Fundraising	1,557,049	1,701,573
Resale	900,703	905,518
Medical store	<u>1,046,030</u>	<u>3,257,420</u>
	<u>\$ 86,565,759</u>	<u>\$ 85,446,860</u>

**NOTE 13 - SUPPORT ORGANIZATION**

HFPBC, an independently managed non-profit corporation, was established in 1985 to exclusively support the programs, services, activities, interest, and organization of HPBC. U.S. GAAP requires HPBC to recognize as an asset its interest in the net assets of HFPBC, and to reflect in its changes in net assets the changes in the net assets of HFPBC. Net assets held by HFPBC as of September 30, 2010 and 2009 amounted to \$16,333,636 and \$15,511,714, respectively.

During 2010 and 2009, HFPBC made grants to HPBC totaling \$625,000 and \$560,000, to provide funding for the following activities:

	<u>2010</u>	<u>2009</u>
Integrative Therapies	\$ 200,000	\$ 200,000
John J. Brogan Bereavement Center Fund	200,000	150,000
Palliative Medicine Fellowship Grant	225,000	140,000
Jewish Hospice Programming	-	50,000
End-of-Life Doulas Program	<u>-</u>	<u>20,000</u>
	<u>\$ 625,000</u>	<u>\$ 560,000</u>

These grants were initially recognized as temporarily restricted net assets, and portions have been reclassified to unrestricted net assets upon meeting their purpose requirements.

**NOTE 14 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS**

U.S. GAAP defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in Organization's principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

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**NOTE 14 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS (Continued)**

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

In many cases, a valuation technique used to measure fair value includes inputs from multiple levels of the fair value hierarchy. The lowest level of significant input determines the placement of the entire fair value measurement in the hierarchy.

Assets measured at fair value on a recurring basis are summarized below:

	<u>Fair Value Measurements at September 30, 2010</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Cash and cash equivalents	\$ 1,504,432	\$ -	\$ -	\$ 1,504,432
Equity securities - large cap	491,201	-	-	491,201
Equity securities - mid cap	3,139,392	-	-	3,139,392
Equity securities - small cap	46,972	-	-	46,972
Equity securities - international	33,188	-	-	33,188
Equity mutual funds	8,333,444	22,431,095	-	30,764,539
Fixed income mutual funds	13,712,282	12,594,521	-	26,306,803
Real assets mutual funds	-	1,942,931	4,468,337	6,411,268
Fund of funds	-	-	<u>16,524,845</u>	<u>16,524,845</u>
Total investments	<u>27,260,911</u>	<u>36,968,547</u>	<u>20,993,182</u>	<u>85,222,640</u>
Interest in net assets of HFPBC	<u>-</u>	<u>-</u>	<u>16,333,636</u>	<u>16,333,636</u>
Total assets	<u>\$ 27,260,911</u>	<u>\$ 36,968,547</u>	<u>\$ 37,326,818</u>	<u>\$101,556,276</u>

	<u>Fair Value Measurements at September 30, 2009</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Cash and cash equivalents	\$ 7,099,126	\$ -	\$ -	\$ 7,099,126
Equity securities - large cap	463,054	-	-	463,054
Equity securities - mid cap	2,787,367	-	-	2,787,367
Equity securities - small cap	145,075	-	-	145,075
Equity mutual funds	6,086,215	19,420,705	-	25,506,920
Fixed income mutual funds	10,916,402	7,860,090	-	18,776,492
Government debt securities	-	202,148	-	202,148
Real assets mutual funds	-	2,724,882	4,733,548	7,458,430
Fund of funds	-	-	<u>16,026,920</u>	<u>16,026,920</u>
Total investments	<u>27,497,239</u>	<u>30,207,825</u>	<u>20,760,468</u>	<u>78,465,532</u>
Interest in net assets of HFPBC	<u>-</u>	<u>-</u>	<u>15,511,714</u>	<u>15,511,714</u>
Total assets	<u>\$ 27,497,239</u>	<u>\$ 30,207,825</u>	<u>\$ 36,272,182</u>	<u>\$ 93,977,246</u>

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**NOTE 14 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS (Continued)**

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	<u>Real Assets</u>	<u>Fund of Funds</u>	Interest in Net Assets of <u>HFPBC</u>	<u>Total</u>
Assets at October 1, 2008	\$ 8,627,823	\$ 15,322,680	\$ 16,296,695	\$ 40,247,198
Investment income	(3,857,224)	896,735	-	(2,960,489)
Change in beneficial interest in net assets of Foundation	-	-	(784,981)	(784,981)
Sales of investments	<u>(37,051)</u>	<u>(192,495)</u>	<u>-</u>	<u>(229,546)</u>
Assets at September 30, 2009	4,733,548	16,026,920	15,511,714	36,272,182
Investment income	415,368	1,082,925	-	1,498,293
Change in beneficial interest in net assets of Foundation	-	-	821,922	821,922
Purchases of investments	-	375,000	-	375,000
Sales of investments	<u>(680,579)</u>	<u>(960,000)</u>	<u>-</u>	<u>(1,640,579)</u>
Assets at September 30, 2010	<u>\$ 4,468,337</u>	<u>\$ 16,524,845</u>	<u>\$ 16,333,636</u>	<u>\$ 37,326,818</u>

All investment income shown in the table above relates to investments that are still held by the Organization at September 30, 2010.

Inputs and Valuation Techniques

In determining fair value, management uses various valuation approaches. With respect to investments for which quoted prices in active markets are observable (Level 1 inputs), management determines fair value based on the quoted prices at the measurement date.

With respect to investments using significant observable inputs other than Level 1 prices (Level 2) or significant unobservable inputs (Level 3) management determines fair value using the net asset value ("NAV"), but incorporates information such as historical and current performance of underlying assets, cash flow projections, levels of subscription and redemption, liquidity, and financial trend analysis of individual investment managers. The NAVs of investment vehicles are determined on the accrual basis of accounting in conformity with U.S. GAAP. Investment managers utilize standard valuation procedures and policies to assess the fair value of the underlying investment holdings to derive NAV. For holdings in marketable securities listed on national securities exchanges, the values represent the publicly traded values, and holdings in private securities are generally valued using the mark-to-market method, which attempts to apply a fair value standard by referring to meaningful third-party transactions, comparable public market valuations, appraisals, and/or the income approach.

In most instances, the Organization possesses the ability to redeem its investment at the NAV at the measurement date (Level 2 inputs), and in some instances additional restrictions on redemption, such as lock-ups and gates, are in place such that investment redemption at NAV is not possible at the measurement date (Level 3 inputs). The Organization's management has done considerable independent review of valuations reported by investment managers and determined that NAV is a reasonable and prudent estimate of fair value.

**NOTE 14 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS (Continued)**

*Equity Securities*

The fair values of equity securities are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs). Common stocks include a variety of large cap, mid cap, small cap, and international companies which have varying levels of capitalization.

*Equity Mutual Funds*

Equity mutual funds consist of mutual funds which are primarily invested in equity securities. The fair values of mutual funds, which are readily marketable, are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs). For equity mutual funds not traded on an active market, the Organization's management has full transparency to the holdings of the funds, and the fair value of these investments is based on NAV, which is determined by the managers based upon the market prices of the underlying holdings of the funds (Level 2 inputs).

*Fixed Income Mutual Funds*

Fixed income mutual funds consist of mutual funds which are primarily invested in fixed income securities. The fair values of mutual funds, which are readily marketable, are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs). For fixed income mutual funds not traded on an active market, the Organization's management has full transparency to the holdings of the funds, and the fair value of these investments is based on NAV, which is determined by the managers based upon the market prices of the underlying holdings of the funds (Level 2 inputs).

*Government Debt Securities*

The fair values of government debt securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

*Real Asset Mutual Funds*

Real asset mutual funds consist of mutual funds invested in commodities and futures contracts, as well as funds invested in real estate securities and other real estate investments. The fair value of real asset mutual funds is based on several valuation techniques including NAV reported by fund managers, which is determined by managers based on the value of underlying holdings of the funds (Level 2 and 3 inputs).

*Funds of Funds*

Funds of funds consist of mutual funds or limited partnerships invested in various funds with investment objectives focused on directional hedge and absolute return strategies. The fair value of funds of funds investments is based on several valuation techniques including NAV reported by fund managers, which is determined by managers based on the value of underlying holdings of the funds (Level 2 and 3 inputs).

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**NOTE 14 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS (Continued)**

*Interest in Net Assets of HFPBC*

The interest in the net assets of HFPBC is largely composed of underlying investments that have observable inputs and market activity allowing for pricing based on the market prices of the items in the investments. Another portion of HFPBC's investments consist of alternative investments (hedge funds) that have observable inputs and market activity allowing for pricing based on the underlying market prices of the items in the investments, utilizing the market approach and income approach valuation techniques. Management utilizes information such as historical and current performance of the underlying funds and financial trend analysis with respect to the interest compared to benchmark performance ratios.

Fair Values Based on Calculated Net Asset Values (NAV)

The table below presents liquidity information pertaining to investments for which fair values are determined on the basis of NAV and other valuation techniques at September 30, 2010:

	<u>Fair Value</u>	<u>Redemption Frequency</u>	<u>Redemption Notice</u>
Domestic equity funds	\$ 5,210,830	Daily	1-30 days
International equity funds	17,220,265	Daily, Monthly	1-30 days
Fixed income funds	12,594,521	Bi-Monthly, Monthly	1-30 days
Commodities funds	1,942,931	Monthly	1-30 days
Real estate funds	4,468,337	Quarterly	Currently gated
Absolute return funds	8,301,959	Annually	90 days
Directional hedge funds	<u>8,222,886</u>	Annually	60 days
Level 2 and Level 3	<u>\$ 57,961,729</u>		

Domestic Equity Funds: The funds' objectives are to seek long-term growth of capital through investment in publicly traded equities of large cap corporations based in the United States. At September 30, 2010, there are no restrictions on redemption.

International Equity Funds: The primary objective of these funds is to achieve long-term growth of capital. In pursuing this objective, these funds invest in diversified portfolios of small cap, mid cap, and large cap equity securities in countries other than the United States. The underlying assets of these funds consist of equities that are traded on international stock exchanges throughout the world. At September 30, 2010, there are no restrictions on redemption.

Fixed Income Funds: The objectives of these funds are to achieve favorable income-oriented returns and total investment return through investment in fixed income securities. An associated objective is the preservation and enhancement of principal. In pursuing these objectives these funds invest in government bonds issued in countries throughout the world, as well as other debt securities in large corporations mostly based in the United States. At September 30, 2010, there are no restrictions on redemption.

Commodities Funds: The objectives of these funds are to provide an enhancement to investors' portfolios and to provide a partial inflation hedge with an attractive risk return profile as compared to other products using a commodity index as a pool of commodities. To achieve these objectives, these funds invest substantially all of their assets through a "master-feeder" structure in investment companies with the same objectives as the fund ("master funds"). The master funds majority holdings consist of short term U.S. treasury bills and futures contracts with expiration dates between 1 and 10 months. Future contracts in the master funds are freely traded and listed on a national futures exchange. At September 30, 2010, there are no restrictions on redemption.

**NOTE 14 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS (Continued)**

Real Estate Funds: These funds are designed to permit investors to commingle a portion of their assets for investment in both publicly owned real estate securities and privately owned real estate investments. Underlying assets in these funds consist of publicly traded real estate securities (in managed accounts), investment in private real estate operating companies, private real estate partnerships, and privately held real estate investment trusts ("REITs"). At September 30, 2010, redemption on these funds is subject to a gate. During the fiscal year, the Organization's management submitted a written request for full redemption of investments in real estate funds. Although gated, these funds will make partial redemptions as underlying assets are realized and as liquidity permits. During the year ended September 30, 2010, a partial redemption totaling \$651,838 was made from the funds. Subsequent to September 30, 2010, an additional redemption totaling \$444,654 was made from the funds.

Absolute Return Funds: The funds' objective is to achieve long-term growth of capital with reduced volatility. In pursuing this objective, the funds allocate capital among various money managers that, as a group, employ a variety of investment techniques and strategies. By investing through this diverse group, the funds seek to provide investors with access to the varied skills and expertise of these managers while at the same time lessening risks and volatility associated with investing through any one particular manager. The funds' underlying assets consist of shares in private equity funds domiciled outside the United States. At September 30, 2010, there are no restrictions on redemption.

Directional Hedge Funds: The funds' objective is to achieve an annual return (over a market cycle) in excess of the S&P 500 and other benchmarks with a meaningfully lower volatility of returns of such benchmarks. These funds invest primarily with hedge fund managers who emphasize fundamental security analysis as the basis for their investment decisions and who manage investment partnerships and other investment vehicles which employ diverse investment styles and strategies. The funds' underlying assets consist of shares in private equity funds domiciled outside the United States. At September 30, 2010, there are no restrictions on redemption.

At September 30, 2010, the Organization has no unfunded commitments to fund these investments.

**NOTE 15 - ENDOWMENT ASSETS**

Overview: As required by U.S. GAAP, HPBC Foundation's endowment fund is classified and reported based on the donor imposed restrictions as permanently restricted net assets. There are no donor-imposed restrictions on the earnings or losses related to investment of endowment funds other than support for HPBC's programs, which is achieved through annual grants made to HPBC from HPBC Foundation. Therefore, earnings or losses from the invested endowment funds are classified as unrestricted. HPBC Foundation does not separately report returns from individual investments. There are no quasi-endowment funds established pursuant to Board designations.

Interpretation of Relevant Law: Florida has not adopted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). HPBC Foundation's Board of Directors has determined the requirements of Florida's version of the UMIFA to center around the preservation of the fair value of the original investment as of the date of the asset transfer. The investments resulting from donations directing that they be invested in perpetuity are classified as permanently restricted. The earnings or losses from these investments are classified based on the donor's direction. For the years ended September 30, 2010 and 2009, earnings and losses from endowment investments are classified as unrestricted due to the donor's direction that the earnings would support the operations of HPBC. HPBC Foundation considers the following factors in making a determination to appropriate or accumulate its endowment funds:

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**NOTE 15 - ENDOWMENT ASSETS** (Continued)

- (1) The duration and preservation of the fund
- (2) The purposes of HPBC Foundation and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of HPBC Foundation
- (7) The investment policies of HPBC Foundation

Return Objectives and Risk Parameters: HPBC Foundation's investment policy centers around the primary objective to preserve and protect its assets while seeking to earn a reasonable total return (income plus capital change) for each segment of its assets appropriate to meet HPBC Foundation's anticipated time horizon, liquidity needs, and risk tolerance for each segment.

Strategies Employed for Achieving Objectives: To satisfy its long-term rate of return objectives, Organization 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). HPBC Foundation targets a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy: HPBC Foundation provides grants to HPBC and others to assist with their programs and services. Grants are made in accordance with donor restrictions, if applicable.

Endowment Net Asset Composition by Type of Fund: HPBC Foundation's composition of donor restricted endowment assets and changes in balances for the years ended September 30 are as follows:

2010:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Beginning balance	\$ (686,232)	\$ -	\$ 2,700,000	\$ 2,013,768
Interest and dividend income	7,400	-	-	7,400
Realized and unrealized gain on investments	<u>174,587</u>	<u>-</u>	<u>-</u>	<u>174,587</u>
Total endowment	<u>\$ (504,245)</u>	<u>\$ -</u>	<u>\$ 2,700,000</u>	<u>\$ 2,195,755</u>

2009:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Beginning balance	\$ (642,842)	-	\$ 2,700,000	\$ 2,057,158
Interest and dividend income	4,205	-	-	4,205
Realized and unrealized loss on investments	<u>(47,595)</u>	<u>-</u>	<u>-</u>	<u>(47,595)</u>
Total endowment	<u>\$ (686,232)</u>	<u>\$ -</u>	<u>\$ 2,700,000</u>	<u>\$ 2,013,768</u>