

SPECTRUM HEALTH INC. AND AFFILIATES

CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2009 and 2008

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Crowe Horwath LLP
Independent Member Crowe Horwath International

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, 2009 and 2008, 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, 2009 and 2008, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

South Bend, Indiana
December 17, 2009

SPECTRUM HEALTH INC. AND AFFILIATES
CONSOLIDATED BALANCE SHEETS
September 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 6,210,744	\$ 4,089,997
Patient accounts receivable, net	8,397,357	7,002,464
Bequests receivable	405,438	56,250
Other current assets	<u>1,640,460</u>	<u>1,200,596</u>
Total current assets	16,653,999	12,349,307
Investments	78,465,532	75,534,766
Interest in net assets of Hospice Foundation of Palm Beach County, Inc. ("HFPBC")	15,511,714	16,296,695
Property and equipment, net	20,927,209	20,430,837
Goodwill, net	334,759	390,551
Deferred financing costs, net	<u>173,914</u>	<u>181,822</u>
	<u>\$ 132,067,127</u>	<u>\$ 125,183,978</u>
LIABILITIES AND NET ASSETS		
Current liabilities		
Current portion of long-term debt	\$ -	\$ 121,919
Accounts payable	634,588	557,400
Accrued payroll and benefits	4,962,036	3,695,053
Accrued expenses and other current liabilities	<u>2,827,134</u>	<u>2,636,439</u>
Total current liabilities	8,423,758	7,010,811
Long-term debt, less current portion	<u>12,000,000</u>	<u>12,000,000</u>
	<u>20,423,758</u>	<u>19,010,811</u>
Net assets		
Unrestricted		
Undesignated	20,861,738	14,736,766
Board designated	<u>70,000,000</u>	<u>70,000,000</u>
Total unrestricted net assets	<u>90,861,738</u>	<u>84,736,766</u>
Temporarily restricted	18,081,631	18,736,401
Permanently restricted	<u>2,700,000</u>	<u>2,700,000</u>
Total net assets	111,643,369	106,173,167
	<u>\$ 132,067,127</u>	<u>\$ 125,183,978</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, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Unrestricted net assets		
Revenues and other support		
Net patient service revenues	\$ 84,449,265	\$ 79,023,295
Resale of donated merchandise	1,169,442	1,314,825
Contributions, memorials, and bequests	6,804,926	3,791,252
Net assets released from restrictions for use in operations	<u>780,827</u>	<u>558,947</u>
	93,204,460	84,688,319
Expenses		
Payroll and related expenses	56,048,527	54,621,866
Patient related expenses	12,838,434	12,751,149
Occupancy and equipment expenses	12,832,558	12,960,840
Other operating expenses	<u>3,548,605</u>	<u>3,742,762</u>
	<u>85,268,124</u>	<u>84,076,617</u>
Change in net assets from operations	7,936,336	611,702
Nonoperating revenues and expenses		
Investment income, net of fees of \$553,512 in 2009 and \$476,841 in 2008	23,466	487,628
Net realized and unrealized loss on investments	(1,753,127)	(16,063,719)
Other non operating expenses	(68,391)	(287,378)
Loss on termination of projects in progress	<u>(13,312)</u>	<u>(367,776)</u>
	<u>(1,811,364)</u>	<u>(16,231,245)</u>
Change in unrestricted net assets	6,124,972	(15,619,543)
Temporarily restricted net assets		
Grants and contributions	911,038	970,237
Change in interest in net assets of HFPBC	(784,981)	(2,604,437)
Net assets released from restrictions	<u>(780,827)</u>	<u>(558,947)</u>
Change in temporarily restricted net assets	<u>(654,770)</u>	<u>(2,193,147)</u>
Change in net assets	5,470,202	(17,812,690)
Net assets at beginning of year	<u>106,173,167</u>	<u>123,985,857</u>
Net assets at end of year	<u>\$111,643,369</u>	<u>\$106,173,167</u>

See accompanying notes to consolidated financial statements.

SPECTRUM HEALTH INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended September 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities		
Change in net assets	\$ 5,470,202	\$ (17,812,690)
Adjustments to reconcile change in net assets to net cash from operating activities		
Depreciation and amortization	2,053,026	2,198,053
Net realized and unrealized loss on investments	1,753,127	16,063,719
Loss on termination of projects in progress	13,312	367,776
Provision for uncollectible accounts	2,732,923	2,474,191
Change in interest in net assets of HFPBC	784,981	2,604,437
Donated property	(274,000)	-
Changes in assets and liabilities		
Patient accounts receivable	(4,127,816)	(3,391,681)
Bequests receivable	(349,188)	(24,050)
Other current assets	(439,864)	613,013
Accounts payable	77,188	(264,635)
Accrued payroll and benefits	1,266,983	475
Accrued expenses and other current liabilities	<u>190,695</u>	<u>229,052</u>
Net cash from operating activities	9,151,569	3,057,660
 Cash flows from investing activities		
Proceeds from sales of investments	35,605,330	27,929,124
Purchases of investments	(40,015,223)	(26,969,058)
Purchases of property and equipment	<u>(2,499,010)</u>	<u>(3,601,600)</u>
Net cash from investing activities	(6,908,903)	(2,641,534)
 Cash flows from financing activities		
Principal payments on long-term debt	<u>(121,919)</u>	<u>(158,795)</u>
Net cash from financing activities	<u>(121,919)</u>	<u>(158,795)</u>
 Net change in cash and cash equivalents	2,120,747	257,331
 Cash and cash equivalents at beginning of year	<u>4,089,997</u>	<u>3,832,666</u>
 Cash and cash equivalents at end of year	<u>\$ 6,210,744</u>	<u>\$ 4,089,997</u>
 Supplemental disclosures of cash flow information		
Cash paid for interest	\$ 148,133	\$ 251,684

See accompanying notes to consolidated financial statements.

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

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")
- Spectrum Healthcare Foundation, Inc., d/b/a Hospice of Palm Beach County Foundation ("HPBC Foundation")
- Hospice Partners On Call, Inc. ("HPOC"), effective October 1, 2008

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.

TMS provides durable medical equipment ("DME") 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. A majority of TMS's revenue is from HPBC.

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. Prior to the formation of HPOC, effective October 1, 2008, the triage call center service was a department within HPBC, serving HPBC, TMS, and a limited number of beta site customers.

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:

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

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

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, 2009 and 2008, the temporarily restricted net assets are primarily restricted for patient-related care and therapeutic activities, in addition to the interest in net assets of Hospice Foundation of Palm Beach County, Inc. ("HFPBC").

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, 2009 and 2008, 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. 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 subject to, and which at times may be in excess of, federally insured amounts. Additionally, for purposes of the statements of cash flows, the Organization considers all highly liquid debt investments purchased with an original maturity of three months or less to be cash equivalents. In October 2008, HPBC entered into an overnight sweep arrangement whereby all cash is moved daily into a treasury-only money market fund.

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.

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

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

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 \$1,109,564 and \$837,745 as of September 30, 2009 and 2008, respectively, is adequate to cover potential losses from uncollectible accounts.

Investments: Investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair value in the consolidated balance sheets. These investments are initially recorded at cost if they were purchased or at their fair market value on the date of the gift if they were received as a donation. Unrealized gains and losses are included in the accompanying consolidated statements of operations and changes in net assets. The investments are primarily held by HPBC Foundation.

Property and Equipment: Property and equipment are stated at cost or, if donated to the Organization, at fair market 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.

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.

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.

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

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

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. The Organization did not exceed the 20% cap related to inpatient days in 2009 and 2008. The second limit relates to an aggregate Medicare reimbursement cap calculated by the Medicare fiscal intermediary. The Organization did not exceed the Medicare cap for the years ended September 30, 2009 and 2008.

Charity Care: The Organization 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 Organization does not expect payment, charges are not included in the net patient service revenues. Charity care is measured using the Organization's established rates and amounted to \$1,397,255 in 2009 and \$1,487,856 in 2008.

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.

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.

Effective December 1, 2007, HPBC Foundation began actively soliciting contributions on behalf of Spectrum and its affiliates.

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

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

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

	<u>2009</u>	<u>2008</u>
Revenue	\$ 534,495	\$ 710,194
Expense	<u>257,136</u>	<u>294,180</u>
Net proceeds	<u>\$ 277,359</u>	<u>\$ 416,014</u>

Revenue is included in contributions, memorials, and bequests, and expenses are included in 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.

Adoption of New Accounting Policy: In 2006, the Financial Accounting Standards Board ("FASB") issued new guidance on fair value measurements of financial instruments. This guidance defines fair value, provides enhanced guidance for using fair value to measure assets and liabilities under current U.S. GAAP standards, and expands the disclosure of the methods used and the effect of fair value measurements on earnings. This guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007. Accordingly, the Organization adopted applicable portions of this guidance for the year ended September 30, 2009.

Subsequent Events: Management has performed an analysis of the activities and transactions subsequent to September 30, 2009 to determine the need for any adjustments to and/or disclosures within the audited financial statements for the year ended September 30, 2009. Management has performed their analysis through the date of this report.

Income Taxes: Spectrum, HPBC, HPBC Foundation, and TMS are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. HPOC has applied for tax exempt status.

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, 2009 and 2008

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, 2009 and 2008, approximately 79% and 83%, respectively, of the Organization's accounts receivable are from Medicare and Medicaid.

At September 30, accounts receivable from third-party payors consists of the following:

	<u>2009</u>	<u>2008</u>
Medicare	\$ 3,346,998	\$ 2,798,663
Medicaid	4,195,937	3,700,397
Private insurance	1,860,108	1,265,659
Patients and others	<u>103,878</u>	<u>75,490</u>
	9,506,921	7,840,209
Less: Allowance for doubtful accounts	<u>(1,109,564)</u>	<u>(837,745)</u>
	<u>\$ 8,397,357</u>	<u>\$ 7,002,464</u>

NOTE 3 - INVESTMENTS

The following are the major categories of investments held by the Organization at September 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Cash and cash equivalents	\$ 7,046,658	\$ 6,438,667
Bonds	202,148	-
Bond funds	18,776,492	18,404,634
Equities	28,954,884	22,700,608
Absolute return	16,026,920	15,501,281
Real assets	<u>7,458,430</u>	<u>12,489,576</u>
	<u>\$ 78,465,532</u>	<u>\$ 75,534,766</u>

Investments consist of cash, equities, mutual funds, exchange traded funds, and private investment funds (alternative investments). Real assets consist primarily of interests in private investment funds invested in real estate and commodity index funds. Investments are carried at fair values, as disclosed in Note 13.

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

NOTE 3 - INVESTMENTS (Continued)

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.

NOTE 4 - PROPERTY AND EQUIPMENT

The Organization's property and equipment at September 30, 2009 and 2008 is as follows:

	<u>2009</u>	<u>2008</u>
Land and improvements	\$ 2,191,915	\$ 1,191,915
Buildings and improvements	18,181,674	16,668,021
Leasehold improvements	1,522,877	1,520,252
Furniture and equipment	4,878,441	4,401,629
Technology costs	5,985,243	5,105,620
Equipment held for rent	775,223	1,050,002
Vehicles	519,511	449,793
Projects in progress	<u>1,145,538</u>	<u>2,276,976</u>
	35,200,422	32,664,208
Less: Accumulated depreciation	<u>(14,273,213)</u>	<u>(12,233,371)</u>
	<u>\$ 20,927,209</u>	<u>\$ 20,430,837</u>

Technology costs include the costs incurred to develop the 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 the Organization's personnel directly related to implementation.

Depreciation expense for the years ended September 30, 2009 and 2008 was \$1,989,326 and \$2,126,453, respectively.

Projects in progress at September 30, 2009 and 2008 primarily relate to inpatient unit renovations and software implementation projects.

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

NOTE 4 - PROPERTY AND EQUIPMENT (Continued)

During the years ended September 30, 2009 and 2008, management abandoned plans to build a new administrative facility and terminated certain software implementation projects. Costs for these projects had previously been recorded as projects in progress. Upon the decision to discontinue the projects, accumulated costs of \$13,312 and \$367,776, respectively, were charged to loss on termination of projects in progress and reported as such in the statements of operations and changes in net assets.

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 0.87% and 2.43% for fiscal years 2009 and 2008, 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 September 2010, and contains a guarantee from Spectrum and HPBC Foundation.

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

Interest expense was \$108,158 and \$291,659 for the years ended, September 30, 2009 and 2008, 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.

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

NOTE 6 - NET ASSETS

The Organization's net assets at September 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Undesignated	\$ 20,861,738	\$ 14,736,766
Board designated		
Operating reserves	50,000,000	50,000,000
Asset additions and replacements	10,000,000	5,000,000
Unfunded programs	7,000,000	7,500,000
Acquisition of facilities	-	5,000,000
Charity care	<u>3,000,000</u>	<u>2,500,000</u>
	<u>70,000,000</u>	<u>70,000,000</u>
Temporarily restricted	18,081,631	18,736,401
Permanently restricted	<u>2,700,000</u>	<u>2,700,000</u>
	<u>\$ 111,643,369</u>	<u>\$ 106,173,167</u>

NOTE 7 - PATIENT SERVICE REVENUES

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

	<u>2009</u>	<u>2008</u>
Government sources		
Medicare	\$ 76,396,780	\$ 71,313,673
Medicaid	<u>4,934,838</u>	<u>4,987,834</u>
	81,331,618	76,301,507
Other sources		
Insurance, private pay, and other third-parties	<u>5,822,779</u>	<u>5,195,979</u>
	87,154,397	81,497,486
Less: Allowances and charity care	<u>(2,705,132)</u>	<u>(2,474,191)</u>
	<u>\$ 84,449,265</u>	<u>\$ 79,023,295</u>

SPECTRUM HEALTH INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

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 2009 and 2008 was \$1,814,610 and \$1,608,745, respectively.

NOTE 9 - LEASES

The Organization leases various patient care facilities, resale shops, and office space under operating leases that extend through December 2014. Total rent expense, included in occupancy and equipment expenses, amounted to \$5,158,262 in 2009 and \$5,183,124 in 2008.

Future minimum payments under the operating leases consist of the following at September 30, 2009:

2010	\$ 4,497,323
2011	2,994,542
2012	2,549,952
2013	1,173,126
2014	1,166,244
Thereafter	<u>80,808</u>
	<u>\$ 12,461,995</u>

NOTE 10 - DONATED SERVICES

The Organization has estimated that during 2009 and 2008 dedicated volunteers have donated hours of service as follows:

	<u>2009</u>	<u>2008</u>
Patient care services	10,749	10,306
Clerical and other services	<u>31,415</u>	<u>33,593</u>
Total hours of service	<u>42,164</u>	<u>43,899</u>

Because those donated services do not meet the recognition criteria of U.S. GAAP, the services have not been recognized as contributions and expenses in the consolidated financial statements.

SPECTRUM HEALTH INC. AND AFFILIATES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 September 30, 2009 and 2008

NOTE 11 - 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>2009</u>	<u>2008</u>
Hospice and palliative care	\$ 68,428,398	\$ 69,034,688
General and administrative	11,043,606	9,988,866
Fundraising	1,701,573	1,082,297
Resale	905,518	1,141,317
Medical store	<u>3,257,420</u>	<u>3,116,827</u>
	<u>\$ 85,336,515</u>	<u>\$ 84,363,995</u>

NOTE 12 - 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, 2009 and 2008 amounted to \$15,511,714 and \$16,296,695, respectively.

During 2009 and 2008, HFPBC made grants to the Organization totaling \$560,000 and \$325,000, to provide funding for the following activities:

	<u>2009</u>	<u>2008</u>
Integrative Therapies	\$ 200,000	\$ 200,000
Palliative Medicine Fellowship Grant	-	125,000
John J. Brogan Bereavement Center Fund	150,000	-
Palliative Medicine Fellowship Grant	140,000	-
Jewish Hospice Programming	50,000	-
End-of-Life Doulas Program	<u>20,000</u>	<u>-</u>
	<u>\$ 560,000</u>	<u>\$ 325,000</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.

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NOTE 13 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS

In 2006, the FASB issued new guidance on fair value measurements of financial instruments. This guidance defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the Organization's principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

In determining fair value, management uses various valuation approaches. FASB utilizes a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Unobservable inputs reflect the Organization's assumptions about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy is categorized into three levels based on the inputs as follows:

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. The fair values of debt and equity investments that are readily marketable are determined by obtaining quoted prices on nationally recognized securities exchanges.

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. Bonds, bond funds, equities, and real assets have observable inputs and market activity that allow for pricing based on the underlying market prices of the items in the fund. Management utilizes information such as historical and current performance of the underlying funds and financial trend analysis with respect to the overall fund compared to benchmark performance ratios.

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. 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, as well as a portion of the Organization's investment portfolio, consist of alternative investments (hedge funds, absolute return, and real assets) 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.

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NOTE 13 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS (Continued)

Management has determined that the adoption of fair value guidance has no material impact on the valuation of the HPBC's assets and liabilities, but does require additional disclosure about fair value measurements. 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 and liabilities measured at fair value on a recurring basis are summarized below:

	<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	\$ 7,046,658	\$ -	\$ -	\$ 7,046,658
Bonds	-	202,148	-	202,148
Bond funds	10,916,402	7,860,090	-	18,776,492
Equities	9,534,179	19,420,705	-	28,954,884
Absolute return	-	-	16,026,920	16,026,920
Real assets	-	<u>2,724,882</u>	<u>4,733,548</u>	<u>7,458,430</u>
Total investments	27,497,239	30,207,825	20,760,468	78,465,532
Interest in net assets of HFPBC	-	-	<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>

A reconciliation of beginning and ending balances for Organization's fair value measurements using Level 3 inputs is as follows:

Level 3 Instruments

	<u>Absolute</u>		<u>Interest in</u>	
	<u>return</u>	<u>Real assets</u>	<u>net assets of</u>	<u>Total</u>
			<u>HFPBC</u>	
Assets at October 1, 2008	\$ 15,322,680	\$ 8,627,823	\$ 16,296,695	\$ 40,247,198
Unrealized gains (losses)	896,735	(3,876,753)	(784,981)	(3,764,999)
Realized gains	-	19,529	-	19,529
Sales of investments	<u>(192,495)</u>	<u>(37,051)</u>	-	<u>(229,546)</u>
Assets at September 30, 2009	<u>\$ 16,026,920</u>	<u>\$ 4,733,548</u>	<u>\$ 15,511,714</u>	<u>\$ 36,272,182</u>

All unrealized and realized gains (losses) shown in the table above relate to investments that are still held by the Organization at September 30, 2009.

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NOTE 14 - 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 year ended September 30, 2009 and 2008, 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:

- (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.

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 September 30, 2009 and 2008

NOTE 14 - ENDOWMENT ASSETS (Continued)

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 is as follows:

2009:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
Donor-restricted	\$ (686,232)	\$ -	\$ 2,700,000	\$ 2,013,768

2008:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
Donor-restricted	\$ (642,842)	\$ -	\$ 2,700,000	\$ 2,057,158

Changes in endowment net assets for the years ended September 30 is as follows:

2009:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>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	(47,595)	-	-	(47,595)
Total endowment	\$ (686,232)	\$ -	\$ 2,700,000	\$ 2,013,768

2008:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
Beginning balance	\$ (227,284)	-	\$ 2,700,000	\$ 2,472,716
Interest and dividend income	9,337	-	-	9,337
Realized and unrealized loss on investments	(424,895)	-	-	(424,895)
Total endowment	\$ (642,842)	\$ -	\$ 2,700,000	\$ 2,057,158
