LAKELAND REGIONAL HEALTH SYSTEMS, INC.
AND SUBSIDIARIES

Consolidated Financial Statements

September 30, 2009 and 2008

(With Independent Auditors' Report Thereon)

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LAKELAND REGIONAL HEALTH SYSTEMS, INC.
AND SUBSIDIARIES

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Independent Auditors' Report

The Board of Directors
Lakeland Regional Health Systems, Inc.:

We have audited the accompanying consolidated balance sheets of Lakeland Regional Health Systems, Inc. and Subsidiaries (the Health System) as of September 30, 2009 and 2008, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Health System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Health System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lakeland Regional Health Systems, Inc. and Subsidiaries as of September 30, 2009 and 2008, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information in schedules 1 and 2 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and changes in net assets of the individual companies. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Date
Certified Public Accountants

LAKELAND REGIONAL HEALTH SYSTEMS, INC.
AND SUBSIDIARIES

Consolidated Balance Sheets

September 30, 2009 and 2008

(In thousands)

Assets		2009	2008
Current assets:			
Cash and cash equivalents	$	55,786	25,783
Short-term marketable securities		21,109	32,952
Current portion of assets limited as to use		6,124	5,646
Patient accounts receivable, less allowance for uncollectible accounts ($60,200 in 2009 and $61,751 in 2008)		75,350	79,570
Estimated third-party settlements		—	3,780
Inventories		10,429	9,871
Prepaid expenses and other current assets		6,917	7,436
Total current assets		175,715	165,038
Assets limited as to use, less current portion		65,437	63,610
Long-term marketable securities		69,834	56,661
Investments		26,500	54,707
Equity in investment funds		98,302	83,116
Property and equipment, net		265,951	272,080
Debt issue costs, net		2,373	2,564
Other assets		3,448	3,831
Total assets	$	707,560	701,607
Liabilities and Net Assets			
Current liabilities:			
Accounts payable and accrued expenses	$	32,168	33,869
Employee compensation and benefits		32,494	31,456
Estimated third-party settlements		4,654	—
State of Florida medical assistance assessment		6,507	5,878
Current portion of long-term debt		5,600	5,335
Total current liabilities		81,423	76,538
Long-term debt, less current portion		196,112	201,580
Long-term liabilities		40,184	39,630
Total liabilities		317,719	317,748
Net assets:			
Unrestricted		383,999	378,457
Temporarily restricted		4,321	3,881
Permanently restricted		1,521	1,521
Total net assets		389,841	383,859
Total liabilities and net assets	$	707,560	701,607

See accompanying notes to consolidated financial statements.

LAKELAND REGIONAL HEALTH SYSTEMS, INC.
AND SUBSIDIARIES

Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2009 and 2008

(In thousands)

		2009	2008
Unrestricted revenues and other support:			
Net patient service revenue	$	572,187	552,493
Other revenues		6,796	5,330
Net assets released from restrictions used in operations		509	487
Total unrestricted revenues and other support		579,492	558,310
Expenses:			
Employee compensation and benefits		270,084	255,263
Supplies		111,828	106,551
General and administrative		71,402	64,152
Professional fees		11,692	12,352
State of Florida medical assistance assessment		6,551	7,385
Provision for bad debts		72,595	60,546
Depreciation		35,889	35,567
Interest		9,932	9,980
Total expenses		589,973	551,796
Operating (loss) income		(10,481)	6,514
Nonoperating gains (losses):			
Investment income (loss)		15,129	(1,944)
Equity in earnings (losses) of investment funds		772	(9,367)
Equity in earnings of the Lakeland Surgical and Diagnostic Center, LLP		1,850	2,719
Equity in losses of the Women's Imaging Center		(169)	(210)
Loss on disposal of property and equipment		(97)	(254)
Total nonoperating gains (losses), net		17,485	(9,056)
Excess (deficit) of revenues, gains, and other support over expenses and losses		7,004	(2,542)

(Continued)

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.
AND SUBSIDIARIES**

Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2009 and 2008

(In thousands)

		2009	2008
Unrestricted net assets:			
Excess (deficit) of revenues, gains, and other support over expenses and losses	$	7,004	(2,542)
Pension-related charges other than net periodic pension cost		(1,588)	—
Net assets released from restrictions used for the purchase of property and equipment		126	398
Increase (decrease) in unrestricted net assets		5,542	(2,144)
Temporarily restricted net assets:			
Contributions		1,131	1,827
Investment income, net		(56)	(96)
Net assets released from restrictions used for the purchase of property and equipment		(126)	(398)
Net assets released from restrictions used in operations		(509)	(487)
Increase in temporarily restricted net assets		440	846
Permanently restricted net assets:			
Contributions		—	1
Increase in permanently restricted net assets		—	1
Increase (decrease) in net assets		5,982	(1,297)
Net assets, beginning of year		383,859	385,156
Net assets, end of year	$	389,841	383,859

See accompanying notes to consolidated financial statements.

LAKELAND REGIONAL HEALTH SYSTEMS, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended September 30, 2009 and 2008

(In thousands)

		2009	2008
Cash flows from operating activities:			
Increase (decrease) in net assets	$	7,570	(1,297)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:			
Equity in earnings of the Lakeland Surgical and Diagnostic Center, LLP		(1,850)	(2,719)
Equity in losses of the Women's Imaging Center		169	210
Equity in (earnings) losses of investment funds		(772)	9,367
Loss on disposal of property and equipment		97	254
Restricted contributions and investment income		(1,075)	(1,303)
Depreciation		35,889	35,567
Amortization of bond premium/discounts		132	107
Amortization of debt issue costs		191	190
Provision for bad debts		72,595	60,546
Changes in operating assets and liabilities:			
Patient accounts receivable		(68,375)	(59,600)
Inventories		(558)	(298)
Prepaid expenses and other current assets		519	861
Trading securities		10,158	8,547
Accounts payable and accrued expenses		(1,701)	(1,482)
Employee compensation and benefits		1,038	2,415
Estimated third-party settlements		8,434	(1,497)
State of Florida medical assistance assessment		629	1,414
Long-term liabilities		(2,292)	(504)
Net cash provided by operating activities		60,798	50,778
Cash flows from investing activities:			
Purchases of property and equipment		(28,599)	(36,980)
Net change in other assets		2,064	2,314
Net cash used in investing activities		(26,535)	(34,666)
Cash flows from financing activities:			
Restricted contributions and investment income		1,075	1,303
Payments on long-term debt		(5,335)	(4,870)
Net cash used in financing activities		(4,260)	(3,567)
Increase in cash and cash equivalents		30,003	12,545
Cash and cash equivalents, beginning of year		25,783	13,238
Cash and cash equivalents, end of year	$	55,786	25,783
Supplemental disclosures of cash flow information:			
Cash paid during the year for interest	$	10,534	10,703
Equipment financed through capital lease		1,258	5,508

See accompanying notes to consolidated financial statements.

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

Lakeland Regional Health Systems, Inc. (the Parent) is a tax-exempt parent holding company organized to promote the continued development of high-quality, cost-effective healthcare services in Lakeland, Florida (the City). The consolidated financial statements include the accounts of the Parent and its subsidiaries: Lakeland Regional Medical Center, Inc. (the Medical Center), Lakeland Regional Health Ventures, Inc. (Ventures), and Lakeland Regional Medical Center Foundation, Inc. (the Foundation). The consolidated entities are hereinafter referred to as the Health System. All significant intercompany transactions among these entities have been eliminated from the consolidated financial statements.

The Medical Center has a lease and transfer agreement (the Agreement) with the City, whereby the Medical Center was formed primarily to manage, control, govern, and lease the existing medical center facility. In consideration of the Agreement, the Medical Center makes annual payments to the City based on a formula that takes into consideration the net revenues of the Medical Center, as defined in the Agreement, and net income of certain affiliated organizations, as defined in the Agreement.

(b) Mission Statement

The Health System's vision is to create the best healthcare experiences. The Health System's core purpose/mission is to improve lives by delivering exceptional health care.

(c) Use of Estimates

The preparation of these consolidated financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(d) Net Patient Service Revenue

The Health System has agreements with third-party payors that provide for payments to the Health System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at estimated net realizable amounts due from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Net patient service revenue was decreased by approximately $5,024,000 and $1,150,000 for the years ended September 30, 2009 and 2008, respectively, for adjustments to prior year estimated third-party settlements.

(Continued)

Approximately 35% and 36% of net patient service revenue is derived from Medicare, 9% and 8% from Medicaid, and 39% and 43% from managed care programs for the years ended September 30, 2009 and 2008, respectively.

(e) ***Nonoperating Gains (Losses)***

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenues and expenses. Activities that result in gains or losses unrelated to the Health System's operations are considered to be nonoperating. Nonoperating gains (losses) include investment income and dividends on unrestricted investments, equity in the earnings (losses) of investment funds, the Lakeland Surgical and Diagnostic Center, LLP (the Surgical Center), the Women's Imaging Center, losses on debt refinancing, and gains and losses on disposals of assets.

(f) ***Excess (Deficit) of Revenues, Gains, and Other Support Over Expenses and Losses***

The accompanying consolidated statements of operations and changes in net assets include excess (deficit) of revenues, gains, and other support over expenses and losses. Changes in unrestricted net assets, which are excluded from excess of revenues, gains, and other support over expenses and losses, consistent with industry practice, include contributions of long-lived assets, including assets acquired using contributions, which by donor restriction were to be used for the purpose of acquiring such assets.

(g) ***Donor-Restricted Gifts***

Unconditional promises to give cash and other assets to the Health System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as revenue if used in operations and as a change in unrestricted net assets if used for the purchase of property and equipment. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

(h) ***Charity Care***

The Health System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. A patient is classified as a charity patient by reference to certain established policies of the Health System. Because the Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Partial payments to which the Health System is entitled from public assistance and other programs on behalf of patients that meet the Health System's charity care criteria are reported as net patient service revenue in the accompanying consolidated statements of operations and changes in net assets.

The Health System maintains records to identify and monitor the level of charity care and public assistance and other program services provided. These records include the amount of charges forgone for services and supplies furnished under its charity care policy and the estimated cost of those services and supplies. The following is information regarding the level of charity care provided (in thousands):

	Years ended September 30	
	2009	**2008**
Charges forgone, based on established rates	$ 420,584	355,563

(i) ***Cash and Cash Equivalents***

Cash and cash equivalents include highly liquid investments with a remaining maturity of three months or less at date of acquisition, excluding amounts included in assets limited as to use.

(j) ***Allowances for Uncollectible Accounts and Contractuals***

Accounts receivable are recorded at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered. The allowance for uncollectible accounts is maintained at the amount estimated to be sufficient to absorb future write-offs of bad debts, net of estimated recoveries. In evaluating the provision for bad debts, management considers past trends in write-offs and subsequent recoveries, general economic conditions, and the age and balance of outstanding accounts. The Health System performs an account-by-account review to identify accounts to be written off.

Additions to the allowance for uncollectible accounts are made by means of the provision for bad debts. Accounts receivable are written off after collection efforts have been followed in accordance with the Health System's policies. Accounts written off as uncollectible are deducted from, and subsequent recoveries are added to, the allowance for uncollectible accounts. The provision for bad debts was increased by $1,113,000 and increased $4,115,000 for the years ended September 30, 2009 and 2008, respectively, for adjustments to prior year estimated allowances for uncollectible accounts.

(k) ***Trading Securities***

The Health System's investment securities are managed by external investment managers that are authorized to buy and sell investment securities in accordance with the Health System's approved investment policy. Since the Health System's investment securities are actively managed by outside investment managers, the Health System has classified its marketable securities and assets limited as to use as trading securities. Investment income (including realized gains and losses on investments, unrealized gains and losses, interest, and dividends) is included in excess (deficit) of revenues, gains, and other support over expenses and losses.

(l) Marketable Securities

Marketable securities are recorded at fair value in the accompanying consolidated balance sheets and consist of equity and debt securities. The fair value of marketable securities is based on quoted market prices.

(m) Assets Limited as to Use

Assets limited as to use include assets internally designated by the board of directors for future capital improvements, medical malpractice, workers' compensation, and medical self-insurance, over which the board of directors retains control and may, at its discretion, subsequently use for other purposes. Assets limited as to use are included in the consolidated balance sheets at their fair values, which are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

(n) Investments

Investments consist of the assets internally designated for the Supplemental Executive Retirement Plan (SERP), certain investments of the Foundation, and the Health System's ownership interest in various limited partnerships and investment funds (collectively referred to as Funds) that, in turn, invest the capital of the Funds in other funds. These Funds are not readily marketable as defined in relevant accounting literature. Therefore, these Funds are recorded based on the historic cost method, and gains and losses are recognized as investment income in the accompanying consolidated statements of operations and changes in net assets at the time of sale, unless a decline in fair value below cost is determined to be other-than-temporary. An other-than-temporary decline in fair value below cost is recognized at the point in time that the determination is made. There were no charges recorded for other-than-temporary declines in fair value for the years ended September 30, 2009 and 2008.

At September 30, 2009, the cost and fair value of investments in Funds recorded on the historic cost method, as reported by the related Fund managers to the Health System, is approximately \$26,500,000 and \$28,800,000, respectively. At September 30, 2008, the cost and fair value of investments in Funds recorded on the historic cost method, as reported by the related Fund managers to the Health System, is approximately \$43,997,000 and \$48,315,000, respectively.

(o) Equity in Investment Funds

Equity in investment funds includes investments in Funds where the Health System's ownership exceeds 5%. Consistent with relevant accounting literature, the Health System has established a policy to account for investments in Funds that exceed 5% ownership interests under the equity method of accounting. Under this method of accounting, the Health System records its share of the earnings or losses of the investee Funds as equity in earnings of investment funds in the accompanying consolidated statements of operations and changes in net assets. At September 30, 2009 and 2008, the equity method value approximated the fair value of the Funds as reported by the related Fund managers to the Health System.

An other-than-temporary decline in the value of the investment in the investee fund is recognized at the time it is determined that such a decline in fair value has occurred. There were no charges recorded for other-than-temporary declines in fair value for the years ended September 30, 2009 and 2008.

The Health System owns greater than 5% of the ownership interests in four Funds. These Funds have no significant liabilities, and the equity of the Funds is based upon the fair value of the financial instruments held. The earnings and losses of the Funds result from the dividends, interest, and realized and unrealized gains or losses of the financial instruments held. Two of these Funds invest directly in other funds that, in turn, invest primarily in financial instruments that are readily marketable in various public markets, some of which are international. The other two Funds invest in real estate, hedge funds, derivatives, and limited partnerships. The fair value of these investments is determined by the underlying asset's manager or independent appraisals (in the case of real estate). Due to the inherent uncertainty of these estimates, these values may differ materially from the values that would have been used had a ready market for these investments existed.

(p) Inventories

Inventories consist principally of medical and surgical supplies and pharmaceuticals and are valued at the lower of cost (first-in, first-out method) or market.

(q) Property and Equipment

Property and equipment have been recorded at historical cost at the date of acquisition or fair value at the date of donation. The cost of repairs and maintenance is charged to expense as incurred and remodeling and refurbishing costs are capitalized. Major asset classifications and useful lives are generally in accordance with those recommended by the American Hospital Association. The straight-line method of depreciation is used for all depreciable assets. Estimated useful lives by asset category are as follows:

Buildings and improvements	5 to 40 years
Equipment	3 to 30 years

Interest costs incurred as part of related construction projects are capitalized during the period of construction. Net interest capitalized for the years ended September 30, 2009 and 2008, was approximately $505,000 and $599,000, respectively.

The Health System had construction commitments of approximately $10,787,000 relating to the purchase or construction of various fixed assets as of September 30, 2009.

(r) Debt Issue Costs

Costs incurred in connection with the issuance of long-term debt are capitalized and amortized over the life of the debt using the straight-line method, which approximates the effective interest method. Amortization of debt issue costs of approximately $191,000 and $190,000, respectively, is included in interest expense in the accompanying consolidated statements of operations and changes in net assets for the years ended September 30, 2009 and 2008. Accumulated amortization of debt issue costs is approximately $1,213,000 and $1,022,000 at September 30, 2009 and 2008, respectively.

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(s) ***Bond Discounts and Premiums***

Bond discounts and premiums are being amortized using the effective interest method over the life of the related debt. Long-term debt on the consolidated balance sheets is stated net of the related bond discounts and premiums.

(t) ***Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by the Health System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Health System in perpetuity.

(u) ***Income Taxes***

The Parent, Medical Center, and Foundation have been recognized by the Internal Revenue Service as tax-exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code of 1986. Income earned in furtherance of the organizations' tax-exempt purposes is exempt from federal and state income taxes. Income taxes related to Ventures, a taxable entity, and the Health System's ownership interest in Surgical Center are not material to the Health System.

(v) ***Collective Bargaining Agreements***

The Medical Center's registered nurses and technical employees are represented by the United Food and Commercial Worker's Union. The registered nurses' contract expires on April 30, 2010. The technical employees' contract expired on April 30, 2008 and has been extended for another three years. Approximately 33% of the Medical Center's total employees are represented by the union contracts. The registered nurses represent 70% of the employees under union contract.

(w) ***New Accounting Pronouncements***

Effective October 1, 2008, the Health System adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820 for *Fair Value Measurements and Disclosures* (Topic 820), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Topic 820 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements. The adoption of Topic 820 did not have a material impact on the Health System's financial statements.

Effective October 1, 2008, the Health System adopted FASB ASC Topic 825 for *The Fair Value Option for Financial Assets and Financial Liabilities* (Topic 825). Topic 825 permits companies to measure certain financial assets and financial liabilities at fair value, at specified election dates. The election may be applied to financial assets and liabilities on an instrument-by-instrument basis, is irrevocable, and may only be applied to entire instruments. Since the Health System did not utilize the fair value option for any allowable items not already reported at fair value, the adoption of Topic 825 did not have a material impact on the Health System's consolidated financial statements.

(Continued)

(2) Marketable Securities and Assets Limited as to Use

Certain investments are included in an investment pool maintained by the Health System for which the Health System and certain of its affiliated organizations are the only participants. The combined funds are included in various investment pools, which are managed by external investment managers. The allocation of the Health System's funds into major security types is based on its proportional share of the various pools stated at fair value.

Marketable securities and assets limited as to use, stated at fair value, include the following (in thousands):

		September 30	
		2009	2008
Cash equivalents	$	1,199	3,468
U.S. Treasury obligations		3	5,421
Corporate obligations		29,198	19,189
Equity securities		28,926	21,597
U.S. government securities		—	116
U.S. mortgage-backed securities		1,142	44,767
Mutual funds		101,647	63,744
Accrued investment income		392	567
		162,507	158,869
Less amount included in current assets		(27,233)	(38,598)
	$	135,274	120,271

The composition of assets limited as to use, stated at fair value, is as follows (in thousands):

		September 30	
		2009	2008
Internally designated by the board of directors:			
Capital improvement fund	$	33,316	31,530
Self-insurance funds		38,245	37,726
Total internally designated		71,561	69,256
Less amount included in current assets		(6,124)	(5,646)
Total assets limited as to use	$	65,437	63,610

Investment income and gains and losses on cash equivalents, marketable securities, assets limited as to use, and investments are composed of the following (in thousands):

		Years ended September 30	
		2009	2008
Excess of revenues, gains, and other support over expenses and losses:			
Interest and dividend income	$	7,724	9,283
Realized and unrealized gains and losses, net		7,405	(11,243)
Gain on interest rate swaps		—	16
	$	15,129	(1,944)

		Years ended September 30	
		2009	2008
Other changes in net assets:			
Temporarily restricted:			
Interest income	$	26	47
Realized gains and losses, net		(82)	(143)
	$	(56)	(96)

(3) Property and Equipment

The components of property and equipment are as follows (in thousands):

		September 30	
		2009	2008
Land	$	7,061	4,731
Buildings and improvements		228,019	222,916
Equipment		415,938	402,836
		651,018	630,483
Less accumulated depreciation		(400,146)	(366,456)
		250,872	264,027
Construction in progress		15,079	8,053
	$	265,951	272,080

(4) Estimated Third-Party Settlements

Estimated third-party settlements include amounts payable or receivable from the Medicare and Medicaid programs. A summary of the significant payment arrangements with these programs is as follows.

(a) Medicare

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on diagnosis and other factors. Also, capital costs and outpatient services are reimbursed at prospectively determined rates. The Health System is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after audit by the fiscal intermediary. The Health System's Medicare cost reports have been audited through September 30, 2006.

(b) Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology, subject to certain limitations. The Health System's payment rates are calculated based on allowable costs included in the most recently filed cost report available at the time of the payment calculation. The Health System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Health System and audits thereof by the Medicaid fiscal intermediary. The Medicaid regulations provide for retroactive settlements between the Health System and the Medicaid program if differences exist in allowable costs between the filed cost report and the audited cost reports. The Health System's Medicaid settlements have been audited by the Medicaid fiscal intermediary through September 30, 1999.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The Health System is aware of these laws and regulations and, to the best of its knowledge and belief, is in compliance. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

(Continued)

(5) Long-Term Debt

The Obligated Group, which includes the Medical Center and the Parent, is obligated under long-term debt as follows (in thousands):

	September 30	
	2009	2008
City of Lakeland, Florida, Hospital Revenue Bonds, Series 2006, including $52,485 of serial bonds due in varying amounts, through November 2026, with interest rates from 4.00% to 5.00% and $60,520 of 5.00% term bonds due November 2032	$ 112,770	113,005
City of Lakeland, Florida, Hospital Revenue Bonds, Series 1999, including $5,525 of serial bonds due in varying amounts through November 2009 with interest rates from 4.88% to 5.00% and $8,290 of serial bonds due in varying amounts through November 2015 with interest rates from 4.88% to 5.45%	10,390	12,150
City of Lakeland, Florida, Hospital Revenue Bonds, Series 1997, including $10,660 of serial bonds due in varying amounts through November 2012 with interest rates from 4.60% to 5.00%, $9,875 of 5.30% term bonds due November 2017, and $26,790 of 5.35% term bonds due November 2022	45,180	47,325
City of Lakeland, Florida, Hospital Revenue Bonds, Series 1996, including $1,195 of serial bonds due in varying amounts through November 2008 with interest rates from 4.80% to 4.90%, $3,945 of 5.00% term bonds due November 2011, and $8,050 and $20,860 of 5.25% term bonds due November 2016 and 2025, respectively	32,855	34,050
	201,195	206,530
Unamortized premium, net	517	385
	201,712	206,915
Less current portion	(5,600)	(5,335)
	$ 196,112	201,580

In November 2006, the Obligated Group issued $113,005,000 in Hospital Refunding Bonds (the Series 2006 Bonds). The proceeds of the Series 2006 Bonds were used to advance refund the 1999A and 2002 Bonds and pay certain costs associated with the issuance of the 2006 Bonds. In July 2002, the Obligated Group issued $60 million in Hospital Revenue Bonds (the Series 2002 Bonds). The proceeds of the Series 2002 Bonds were used to finance and reimburse the costs of acquiring, renovating, and constructing existing and additional healthcare facilities of the Obligated Group. The Series 2006 and 2002 Bonds and all of the existing outstanding bonds are secured under the Series 1999 Master Trust Indenture that contains covenants that require, among other things, the maintenance of certain ratios. These ratios are calculated based on the Obligated Group's financial position and results of operations. Principal and interest payments are secured by all revenues; accounts receivable; contract rights and general intangibles; certain property and equipment; and all funds, accounts, and monies of the Obligated Group held by the City or trustee, or pledged or assigned to such parties. In addition, payment of principal and interest on the outstanding bonds is guaranteed by municipal bond insurance.

Maturities of long-term debt as of September 30, 2009 are as follows (in thousands):

2010	$ 5,600
2011	5,870
2012	6,135
2013	6,445
2014	6,770
Thereafter	170,375
	201,195
Unamortized premium, net	517
	$ 201,712

(6) Leases

The Health System leases equipment and facilities under operating leases expiring at various dates through 2015. Minimum future rental payments under noncancelable operating leases having terms in excess of one year are as follows (in thousands):

2010	$ 2,360
2011	1,259
2012	507
2013	384
2014	144
Thereafter	43
	$ 4,697

(Continued)

Rental expense under operating leases amounted to $3,740,000 and $3,241,000 for the years ended September 30, 2009 and 2008, respectively, and is included in general and administrative expenses in the consolidated statements of operations and changes in net assets.

(7) Long-Term Liabilities

Long-term liabilities are as follows (in thousands):

		September 30	
		2009	**2008**
State of Florida medical assistance assessment	$	3,212	3,616
Section 457(f) benefit plan liability		5,245	6,150
Workers' compensation claims		1,909	1,909
Capital lease obligations		2,810	3,952
Accrued malpractice liability		27,008	25,591
	$	40,184	41,218

(8) Employee Benefits

The Health System provides retirement and other benefits to substantially all employees through several benefit plans. Under the defined contribution plan (the Plan), for all employee groups who meet minimum service requirements, the Health System contributes 5% of eligible employee wages up to the taxable wage base for Social Security tax purposes for each plan year and 10% of eligible employee wages in excess of the taxable wage base for each plan year up to a maximum base amount. In addition to the calculated annual contributions, the board of directors may establish an additional discretionary contribution to be made to the Plan for each year. Employees are fully vested after completing three years of service with at least 1,000 hours of service in each year.

In 2004, the Medical Center established a SERP under Section 457(f) of the Internal Revenue Code. The SERP is a nonqualified defined benefit plan limited to certain management or highly compensated employees as determined by the Medical Center. Upon vesting, the SERP provides participants with deferred compensation annually for 20 years, equal to 2% of the participant's final average compensation multiplied by his/her years of service (up to a maximum of 25 years of service). Compensation is based on participants' average compensation during the last three complete calendar years. Only calendar years beginning on or after January 1, 2004 are considered. Vesting is generally effective after a participant completes five years of service with the Medical Center; however, the initial participants had individual vesting schedules. The SERP also provides for certain death or disability benefits. The Medical Center is accounting for the SERP in accordance with relevant accounting literature and has recognized credit for past service costs.

The actuarially computed net periodic pension cost for the Medical Center's SERP for the years ended September 30, 2009 and 2008 included the following components using a measurement date of September 30 (in thousands):

		2009	2008
Service cost – benefits earned during the period	$	778	718
Interest cost on projected benefit obligation		524	513
Amortization of prior service cost		323	323
Settlement loss		325	79
Net amortization and deferral of unrecognized losses		64	—
Net periodic pension cost	$	2,014	1,633

The following table sets forth the SERP's funded status and amount recognized in other liabilities in the Medical Center's consolidated balance sheets as of September 30, 2009 and 2008:

		2009	2008
Change in benefit obligation:			
Benefit obligation at beginning of year	$	9,899	10,889
Service cost		778	718
Interest cost		524	513
Actuarial gain		(372)	1,129
Benefits paid		(2,604)	(3,350)
Benefit obligation at end of year		8,225	9,899
Fair value of plan assets at end of year		—	—
Funded status and accrued benefit costs	$	(8,225)	(9,899)

The board of directors has designated investments of approximately $7,040,000 and $5,369,000 for the Section 457(f) benefit plan at September 30, 2009 and 2008, respectively. These assets, however, are not in trust for the Plan and do not qualify as assets of the Plan under relevant accounting literature. The accumulated benefit obligation for the SERP was $6,577,000 and $7,468,000 at September 30, 2009 and 2008, respectively.

Weighted average assumptions used to determine projected benefit obligations at September 30, 2009 and 2008 were as follows:

	2009	2008
Discount rate	5.75%	6.50%
Rate of compensation increase	5.00	5.00

The actuarial assumptions used in determining net periodic pension costs for the years ended September 30, 2009 and 2008 are as follows:

	2009	2008
Discount rate	6.50%	6.25%
Rate of compensation increase	5.00	5.00

Cash Flows

The Medical Center expects to make contributions to its investments of approximately $465,000 during the year ended September 30, 2010.

The benefits expected to be paid in each year from 2010 through 2014 are approximately $465,000, $3,606,000, $204,000, $3,771,000, and $78,000, respectively. The aggregate benefits expected to be paid in the five years from 2015 through 2019 are approximately $3,855,000. The expected benefits are based on the same assumptions used to measure the Medical Center's benefit obligations at September 30, 2009 and include estimated future employee service.

Expenses incurred for all employee benefit plans were $10,991,000 and $10,730,000 for the years ended September 30, 2009 and 2008, respectively, which is included in employee compensation and benefits in the accompanying consolidated statements of operations and changes in net assets.

(9) Functional Expenses

The Health System provides general healthcare services to residents within its geographic area. Expenses related to providing these services are as follows (in thousands):

		2009	2008
Healthcare services	$	541,209	496,616
Other administrative		48,764	55,180
	$	589,973	551,796

(10) Commitments and Contingencies

(a) City Lease Obligation

Under the terms of the Agreement, annual lease payments are made to the City based on a formula, which takes into consideration the net revenues of the Medical Center, as defined in the Agreement, and net income of certain affiliated organizations, as defined in the Agreement. The Agreement expires in 2033. Expenses under the terms of the Agreement, included in general and administrative expenses in the accompanying consolidated statements of operations and changes in net assets, were approximately $11,150,000 and $10,475,000 for the years ended September 30, 2009 and 2008, respectively.

In accordance with FASB ASC 410-20, *Asset Retirement and Environment Obligations – Asset Retirement Obligations*, the Health System conducted a review of its lease obligations and each of its properties to determine if the Health System had any obligations to perform asset retirement activity that may not be within management's control, such as the remediation or removal of asbestos-containing materials. Management's review did not identify any significant issues that might have a material effect on the consolidated financial statements for the years ended September 30, 2009 or 2008.

(b) Litigation

During the normal course of business, the Health System is involved in litigation with respect to professional liability claims and other matters. In addition, the Health System is subject to periodic regulatory investigations. The Health System has purchased insurance coverage to minimize its exposure to such risk. This coverage includes property, directors and officers, vehicles, medical malpractice, and general liability. Each policy has its own deductible and/or self-insurance retention.

(c) Professional Malpractice Insurance

The Health System's current malpractice insurance policy provides for claims-made coverage. Under its current insurance coverage, as well as prior coverage, the Health System is liable for specified deductible amounts. The Health System's self-insured deductible was $250,000 per claim through fiscal year 2001 and $500,000 per claim through fiscal year 2002. Beginning in fiscal year 2003, the Health System's self-insured deductible was increased to $3 million per claim. On September 1, 2003, the Health System added a $2 million inner-aggregate deductible, on top of the $3 million per claim deductible. Effective September 1, 2007, the Health System's annual aggregate self-insured retention is $15 million. Effective October 1, 2001, the Health System became insured through a retrospectively rated insurance agreement with an insurance captive for claims made in excess of $4 million after that date.

Losses from both asserted and unasserted claims are accrued based on estimates that incorporate the Health System's past experience, as well as other considerations, including the nature of each claim or incident, relevant trend factors, and estimates of incurred but not reported amounts. The Health System has engaged an independent actuary to estimate ultimate losses to be accrued. The Health System has internally designated certain funds for the payment of professional liability claim settlements. The balances of the internally designated funds were $29,577,000 and $30,763,000 as of September 30, 2009 and 2008, respectively, and are included in assets limited as to use in the accompanying consolidated balance sheets.

As a provider of healthcare services, the Health System is subject to malpractice claims. Certain of these matters are covered by the insurance arrangements described above. Estimated losses, which are subject to deductible provisions of $28,508,000 and $27,091,000 are included in accounts payable and accrued expenses and long-term liabilities in the accompanying consolidated balance sheets as of September 30, 2009 and 2008, respectively. The Health System may be liable for losses in excess of amounts accrued, but within the deductible provisions. However, in management's opinion, such excess, if any, would not have a material adverse effect on the consolidated results of operations or financial position of the Health System.

(d) Workers' Compensation Liability and Employee Medical Insurance

The Health System is self-insured for workers' compensation claims and employee medical claims. Workers' compensation losses for asserted and unasserted claims are accrued based on estimates provided by an independent actuary. Estimated costs for workers' compensation claims and employee medical claims of $5,677,000 and $6,273,000, respectively, are included in employee compensation and benefits and long-term liabilities in the accompanying consolidated balance sheets as of September 30, 2009 and 2008, respectively. The estimates are based on the Health System's past experience, as well as other considerations, including the nature of each claim or incident, relevant trend factors, and estimates of amounts incurred but not reported. The Health System has established self-insurance funds for the payment of workers' compensation liability claim settlements and employee medical liability claim settlements. The balances of these funds totaled $8,871,000 and $6,963,000 as of September 30, 2009 and 2008, respectively, and are included in assets limited as to use in the accompanying consolidated balance sheets.

(11) Concentration of Credit Risk

The Health System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The Health System does not charge interest on accounts receivable. Approximately $35 million, or 49%, and $38 million, or 49%, of net patient accounts receivable were due from managed care organizations at September 30, 2009 and 2008, respectively. Approximately $10 million, or 13%, and $10 million, or 13%, of net patient accounts receivable were due from the Medicare program at September 30, 2009 and 2008, respectively. Approximately $11 million, or 15%, and $7 million, or 9%, of net patient accounts receivable were due from the Medicaid program at September 30, 2009 and 2008, respectively. The credit risk for other concentrations of receivables is limited due to the large number of insurance companies and other payors that provide payments for services. Accounts receivable are reported net of an estimated allowance for uncollectible accounts in the accompanying consolidated financial statements.

(12) Investment in Lakeland Surgical and Diagnostic Center, LLP

As of September 30, 2009 and 2008, the Health System had a 43.75% ownership interest in the Surgical Center. The ownership interest is accounted for using the equity method. The equity in earnings of the Surgical Center was $1,850,000 and $2,719,000 for the years ended September 30, 2009 and 2008, respectively. The carrying value of the Health System's investment in the Surgical Center was approximately $3,566,000 and $3,890,000 as of September 30, 2009 and 2008, respectively, and is included in other assets in the accompanying consolidated balance sheets.

(Continued)

(13) Fair Value Measurements

FASB ASC Topic 820 defines fair value as the exit price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 requires investments to be grouped into three categories based on certain criteria as noted below:

Level 1: Fair value is determined by using quoted prices for identical assets or liabilities in active markets.

Level 2: Fair value is determined by using other than quoted prices that are observable for the asset or liability (e.g., quoted prices for identical assets or liabilities in inactive markets, quoted prices for similar assets or liabilities in active markets, observable inputs other than quoted prices, and inputs derived principally from or corroborated by observable market data by correlation or other means).

Level 3: Fair value is determined by using inputs based on management assumptions that are not directly observable.

The table below summarizes the fair values of the Health System's significant financial assets and liabilities as of September 30, 2009 (in thousands):

		Fair value measurements at reporting date using		
	September 30, 2009	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Assets limited as to use and marketable securities	$ 162,507	132,164	30,343	—
	$ 162,507	132,164	30,343	—

The Health System's Level 1 includes trading investments in equity securities and mutual funds and is valued at the quoted market prices.

The Health System's Level 2 assets and liabilities include trading investments in U.S. Treasuries and agency obligations, government securities, corporate debt securities, international bonds, certificates of deposit, and asset-backed securities with fair values modeled by external pricing vendors.

The Health System does not hold any investments that are carried at fair value and valued using Level 3 inputs.

Estimates of fair values are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could affect the estimates. Fair values of the Health System's debt are based upon the quoted market prices for the same or similar issues or on the current rates offered to the Health System for debt of the same remaining maturities. The table below summarizes the carrying amount and fair value of the Health System's debt as of September 30, 2009 and 2008 (in thousands):

	2009		2008	
	Carrying amount	**Fair value**	**Carrying amount**	**Fair value**
Long-term debt	$ 201,712	195,595	206,915	194,786

(14) Subsequent Events

Effective September 30, 2009, the Health System adopted FASB ASC No. 855-10-05, *Subsequent Events*, which establishes principles and requirements for subsequent events and applies to accounting for and disclosure of subsequent events not addressed in other applicable generally accepted accounting principles. The Health System evaluated events subsequent to September 30, 2009 and through January __, 2010, the date on which the consolidated financial statements were approved for issuance.

OTHER FINANCIAL INFORMATION

LAKELAND REGIONAL HEALTH SYSTEMS, INC.
AND SUBSIDIARIES

Consolidating Schedule — Balance Sheet Information

September 30, 2009

(In thousands)

Assets	Lakeland Regional Health Systems, Inc.	Lakeland Regional Medical Center, Inc.	Eliminations	Obligated Group	Lakeland Regional Health Ventures, Inc.	Lakeland Regional Medical Center Foundation, Inc.	Eliminations	Total
Current assets:								
Cash and cash equivalents	$ 55,154	267	—	55,421	—	365	—	55,786
Short-term marketable securities	20,925	—	—	20,925	184	—	—	21,109
Current portion of assets limited as to use	6,124	—	—	6,124	—	—	—	6,124
Patient accounts receivable, net	2,338	72,630	—	74,968	382	—	—	75,350
Inventories	—	10,429	—	10,429	—	—	—	10,429
Prepaid expenses and other current assets	329	6,094	—	6,423	—	494	—	6,917
Due from affiliates	205	6,124	(6,124)	205	(201)	(4)	—	—
Total current assets	85,075	95,544	(6,124)	174,495	365	855	—	175,715
Assets limited as to use, less current portion	65,437	—	—	65,437	—	—	—	65,437
Due from affiliates, less current portion	—	64,568	(64,568)	—	—	—	—	—
Long-term marketable securities	63,205	—	—	63,205	—	6,629	—	69,834
Investments	16,392	7,040	—	23,432	2	3,066	—	26,500
Equity in investment funds	97,206	—	—	97,206	—	1,096	—	98,302
Property and equipment, net	11,928	254,020	—	265,948	—	3	—	265,951
Interest in net assets of the Foundation	707	10,572	—	11,279	—	—	(11,279)	—
Debt issue costs, net	2,373	—	—	2,373	—	—	—	2,373
Other assets	3,938	10	—	3,948	—	—	(500)	3,448
Total assets	$ 346,261	431,754	(70,692)	707,323	367	11,649	(11,779)	707,560

(Continued)

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.
AND SUBSIDIARIES**

Consolidating Schedule — Balance Sheet Information

September 30, 2009

(In thousands)

	Lakeland Regional Health Systems, Inc.	Lakeland Regional Medical Center, Inc.	Eliminations	Obligated Group	Lakeland Regional Health Ventures, Inc.	Lakeland Regional Medical Center Foundation, Inc.	Eliminations	Total
Liabilities and Net Assets								
Current liabilities:								
Accounts payable and accrued expenses	$ 4,848	27,173	—	32,021	28	119	—	32,168
Employee compensation and benefits	1,953	30,541	—	32,494	—	—	—	32,494
Estimated third-party settlements	—	4,654	—	4,654	—	—	—	4,654
State of Florida medical assistance	—	6,507	—	6,507	—	—	—	6,507
Current portion of long-term debt	5,600	—	—	5,600	—	—	—	5,600
Due to affiliates	—	—	—	—	—	—	—	—
Total current liabilities	12,401	68,875	—	81,276	28	119	—	81,423
Long-term debt, less current portion	196,112	—	—	196,112	—	—	—	196,112
Due to affiliates, less current portion	70,692	—	(70,692)	—	—	—	—	—
Long-term liabilities	—	40,184	—	40,184	—	—	—	40,184
Total liabilities	279,205	109,059	(70,692)	317,572	28	119	—	317,719
Net assets:								
Unrestricted	66,479	317,572	—	384,051	339	6,593	(6,984)	383,999
Temporarily restricted	577	3,602	—	4,179	—	3,416	(3,274)	4,321
Permanently restricted	—	1,521	—	1,521	—	1,521	(1,521)	1,521
Total net assets	67,056	322,695	—	389,751	339	11,530	(11,779)	389,841
Total liabilities and net assets	$ 346,261	431,754	(70,692)	707,323	367	11,649	(11,779)	707,560

See accompanying independent auditors' report.

LAKELAND REGIONAL HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Consolidating Schedule — Statement of Operations Information

Year ended September 30, 2009

(In thousands)

	Lakeland Regional Health Systems, Inc.	Lakeland Regional Medical Center, Inc.	Eliminations	Obligated Group	Lakeland Regional Health Ventures, Inc.	Lakeland Regional Medical Center Foundation, Inc.	Eliminations	Total
Unrestricted revenues and other support:								
Net patient service revenue	$ 10,053	562,134	—	572,187	—	—	—	572,187
Other revenues	1,223	5,410	—	6,633	—	163	—	6,796
Net assets released from restrictions used for operations	—	—	—	—	—	509	—	509
Contributions from affiliate	—	—	—	—	—	697	(697)	—
Total unrestricted revenues and other support	11,276	567,544	—	578,820	—	1,369	(697)	579,492
Expenses:								
Employee compensation and benefits	19,774	249,819	—	269,593	—	491	—	270,084
Supplies	549	111,279	—	111,828	—	—	—	111,828
General and administrative	4,400	66,698	—	71,098	36	965	(697)	71,402
Professional fees	1,662	10,030	—	11,692	—	—	—	11,692
State of Florida medical assistance assessment	—	6,551	—	6,551	—	—	—	6,551
Provision for bad debts	—	72,595	—	72,595	—	—	—	72,595
Depreciation	240	35,647	—	35,887	—	2	—	35,889
Interest	9,932	—	—	9,932	—	—	—	9,932
Total expenses	36,557	552,619	—	589,176	36	1,458	(697)	589,973
Operating income (loss)	(25,281)	14,925	—	(10,356)	(36)	(89)	—	(10,481)
Nonoperating gains (losses):								
Investment income	14,018	342	—	14,360	21	748	—	15,129
Equity in earnings (losses) of investment funds	812	—	—	812	—	(40)	—	772
Equity in earnings of the Lakeland Surgical and Diagnostic Center, LLP	1,850	—	—	1,850	—	—	—	1,850
Equity in losses of the Women's Imaging Center	(169)	—	—	(169)	—	—	—	(169)
Loss on disposal of property and equipment	—	(97)	—	(97)	—	—	—	(97)
Total nonoperating gains, net	16,511	245	—	16,756	21	708	—	17,485
Excess (deficit) of revenues, gains, and other support over expenses and losses	$ (8,770)	15,170	—	6,400	(15)	619	—	7,004

See accompanying independent auditors' report.