Strong Memorial Hospital

(A Division of the University of Rochester)

Financial Statements

December 31, 2011 and 2010

(With Independent Auditors' Report Thereon)

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Report of Independent Auditors

To the Audit and Risk Assessment Committee
University of Rochester Medical Center

In our opinion, the accompanying balance sheets and the related statements of operations and changes in net assets and of cash flows present fairly, in all material respects, the financial position of Strong Memorial Hospital (the "Hospital"), a division of the University of Rochester, as of December 31, 2011 and 2010 and the results of its operations and changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

May 22, 2012

PricewaterhouseCoopers LLP, 1100 Bausch & Lomb Place, Rochester, NY 14604-2705
T: (585) 232 4000, F: (585) 454 6594, www.pwc.com/us

Strong Memorial Hospital
(A Division of the University of Rochester)
Balance Sheets
December 31, 2011 and 2010

	2011	2010
Assets		
Current assets		
Cash and cash equivalents	$ 249,117,156	$ 230,576,040
Investments	40,776,440	39,159,786
Patient accounts receivable, net of estimated uncollectible amounts of approximately $39,886,000 and $42,104,000, respectively	84,516,375	87,529,661
Assets whose use is limited	7,206,849	-
Pledges receivable	4,004,902	250,000
Insurance claims receivable	10,885,181	-
Other receivables	53,609,791	47,697,796
Deposits in captive insurance company	1,434,186	1,381,734
Inventory	23,142,013	22,203,520
Other current assets	3,031,580	2,031,844
Total current assets	477,724,473	430,830,381
Assets whose use is limited	27,904,060	5,641,110
Deferred financing costs, net	1,865,195	1,514,040
Pledges receivable	11,517,614	-
Insurance claims receivable	39,258,820	4,837,455
Investments held for long-term purposes	4,720,353	4,701,793
Equity investments	24,231,502	17,652,936
Property and equipment, net	370,222,110	340,649,122
Other noncurrent assets	11,609,147	201,269
Total assets	$ 969,053,274	$ 806,028,106
Liabilities and Net Assets		
Current liabilities		
Current installments of long-term debt	$ 8,515,000	$ 8,010,000
Accounts payable and accrued expenses	43,882,966	44,720,886
Construction accounts payable	19,800,917	5,033,572
Accrued payroll and payroll taxes	24,228,507	19,576,282
Accrued vacation	16,516,530	15,124,456
Accrued postemployment benefits	22,983,780	17,824,520
Accrued postretirement benefits	1,655,687	1,650,200
Accrued professional liability costs	10,885,181	-
Accrued third-party payor settlements	41,171,359	31,709,316
Due to other University of Rochester divisions	19,228,632	14,992,408
Total current liabilities	208,868,559	158,641,640
Accrued postemployment benefits	25,288,303	20,839,935
Accrued postretirement benefits	62,089,770	61,835,299
Accrued professional liability costs	63,526,814	34,069,108
Accrued third-party payor settlements	43,171,184	49,812,150
Fair value of interest rate swaps	15,652,027	10,789,449
Fair value of asset retirement obligation	176,544	179,551
Long-term debt, excluding current installments	177,188,227	144,496,425
Total liabilities	595,961,428	480,663,557
Commitments and contingencies (notes 8, 9 and 17)		
Net assets		
Unrestricted	335,709,616	308,607,516
Temporarily restricted	32,661,877	12,055,240
Permanently restricted	4,720,353	4,701,793
Total net assets	373,091,846	325,364,549
Total liabilities and net assets	$ 969,053,274	$ 806,028,106

The accompanying notes are an integral part of these financial statements.

Strong Memorial Hospital
(A Division of the University of Rochester)
Statements of Operations and Changes in Net Assets
For the Years Ended December 31, 2011 and 2010

	2011	2010
Unrestricted revenues		
Net patient service revenue	$ 1,042,911,722	$ 998,486,499
Other revenue	67,396,730	67,074,538
Net assets released from restrictions - operations	608,092	382,459
Total unrestricted revenues	1,110,916,544	1,065,943,496
Expenses		
Salaries	416,720,831	391,027,712
Benefits	145,382,258	132,987,938
Pharmaceutical and medical supplies	226,700,492	215,827,010
University and Medical Center cost allocations	39,482,572	37,619,064
Professional and contract services	22,409,019	21,860,324
Interest	6,593,403	6,522,843
Depreciation and amortization	50,071,504	47,141,305
Provision for uncollectibles	12,217,598	19,915,930
University of Rochester Medical Faculty Group clinical support	28,187,569	25,894,346
Other expenses	100,889,936	107,142,037
Total expenses	1,048,655,182	1,005,938,509
Income from operations	62,261,362	60,004,987
Other gains (losses), net		
Investment activity	(3,046,037)	3,238,228
Other	1,564,452	(1,449,879)
Total other gains (losses), net	(1,481,585)	1,788,349
Excess of revenues over expenses	60,779,777	61,793,336
Other changes		
Net assets released from restrictions - capital	476,408	1,333,879
Cumulative effect of change in accounting principle	-	(1,306,710)
Transfers to the University of Rochester Medical Center Divisions	(34,154,085)	(29,696,513)
Increase in unrestricted net assets	27,102,100	32,123,992
Temporarily restricted net assets		
Contributions	21,474,404	2,125,347
Investment income	381,505	435,470
Net unrealized gains on investments	8,152	712,364
Change in valuation of deferred gift annuities	(172,924)	20,567
Cumulative effect of change in accounting principle	-	1,306,710
Net assets released from restrictions	(1,084,500)	(1,716,338)
Increase in temporarily restricted net assets	20,606,637	2,884,120
Permanently restricted net assets		
Contributions to endowment	18,560	81,181
Increase in permanently restricted net assets	18,560	81,181
Increase in net assets	47,727,297	35,089,293
Net assets, beginning of year	325,364,549	290,275,256
Net assets, end of year	$ 373,091,846	$ 325,364,549

The accompanying notes are an integral part of these financial statements.

Strong Memorial Hospital
(A Division of the University of Rochester)
Statements of Cash Flows
For the Years Ended December 31, 2011 and 2010

	2011	2010
Cash flows from operating activities		
Increase in net assets	$ 47,727,297	$ 35,089,293
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Depreciation and amortization	50,071,504	47,141,305
Loss on disposal of property and equipment, net	385,158	392,592
Write-off of construction in progress	1,923,143	4,277,777
Transfers to the University of Rochester Medical Center Divisions	34,154,085	29,696,513
Net realized gains on investments	(777,485)	(1,239,437)
Net unrealized losses (gains) on investments	86,257	(2,685,128)
Change in value of interest rate swaps	4,862,578	1,924,872
Asset retirement obligation	(3,007)	(18,946)
Restricted contributions and investment income received	(6,601,953)	(2,641,998)
Provision for uncollectibles	12,217,598	19,915,930
Changes in assets and liabilities		
Pledges receivable	(15,272,516)	16,666
Insurance claims receivable	(45,306,546)	(286,976)
Patient accounts receivable	(9,204,312)	(23,673,398)
Other receivables, inventory and other current assets	(7,850,224)	(30,497,735)
Deposits in captive insurance company	(52,452)	32,688
Other noncurrent assets	(594,400)	(201,269)
Accounts payable, accrued expenses and other current liabilities	5,206,379	27,568,447
Due to other University of Rochester divisions	4,993,521	2,700,150
Accrued third-party payor settlements	2,821,077	10,628,856
Accrued postemployment benefits	9,607,628	3,088,976
Accrued postretirement benefits	259,958	6,456,817
Accrued professional liability costs	40,342,887	704,039
Net cash provided by operating activities	128,996,175	128,390,034
Cash flows from investing activities		
(Increase) decrease in investments	(896,289)	1,589,174
Purchase of property and equipment	(67,193,568)	(60,820,942)
Proceeds from disposal of equipment	112,304	28,750
(Increase) decrease in assets whose use is limited	(29,517,496)	3,220,139
Increase in equity investments	(6,578,566)	(5,579,419)
(Increase) in other noncurrent assets	(10,813,478)	-
Net cash used in investing activities	(114,887,093)	(61,562,298)
Cash flows from financing activities		
Proceeds from long-term debt	41,371,306	-
Repayment of long-term debt and capital lease obligations	(8,174,504)	(7,566,900)
Deferred financing costs	(455,339)	(99)
Due to other University of Rochester divisions	(757,297)	(732,174)
Transfers to the University of Rochester Medical Center Divisions	(34,154,085)	(29,696,513)
Restricted contributions and investment income received	6,601,953	2,641,998
Net cash provided by (used in) financing activities	4,432,034	(35,353,688)
Net increase in cash and cash equivalents	18,541,116	31,474,048
Cash and cash equivalents at beginning of year	230,576,040	199,101,992
Cash and cash equivalents at end of year	$ 249,117,156	$ 230,576,040
Supplemental disclosures of cash flow information		
Cash paid during the year for interest	$ 6,582,376	$ 6,765,251
(Increase) decrease in construction accounts payable	(14,767,345)	2,717,643

The accompanying notes are an integral part of these financial statements.

1. Summary of Significant Accounting Policies and Practices

Strong Memorial Hospital (the "Hospital") is a tertiary care teaching institution located in Rochester, New York. It is an integrated division of the University of Rochester (the "University"). The Hospital provides health care services through its inpatient and outpatient care facilities. Admitting physicians are primarily practitioners in the local area. The Hospital also serves as a referral center for various tertiary and quaternary services throughout Western New York, accounting for approximately 36% of its admissions. The Hospital routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations, and commercial insurance policies).

Basis of Presentation
The Hospital's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, consistent with the *AICPA Audit and Accounting Guide for Health Care Organizations* (Audit Guide). In accordance with the provisions of the Audit Guide, net assets and revenue, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, unrestricted net assets are net assets that are not subject to donor-imposed stipulations and are available for operations. Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Permanently restricted net assets result from donors who stipulate that their donated resources be maintained permanently. The Hospital is permitted to use or expend part or all of the income and gains derived from the donated assets, restricted only by the donors' wishes.

Use of Estimates
The preparation of 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, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The most significant areas which are affected by the use of estimates include the allowance for uncollectible accounts, estimated third-party payor settlements, self-insurance reserves, postretirement and postemployment obligations.

Revenue Recognition
Net patient service revenue is recognized in the period services are performed and is reported at estimated net realizable amounts 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 more current information becomes available or as years are no longer subject to such audits, reviews, and investigations.

Excess of Revenues Over Expenses
The Hospital's excess of revenues over expenses includes all unrestricted revenue, gains, expenses, and losses for the reporting period, except for net assets released from restrictions for capital purposes, transfers to the University of Rochester Medical Center Divisions, and the cumulative effect of change in accounting principle.

Cash and Cash Equivalents
The Hospital's cash is included with the University's cash within the same financial institution account, which mainly consists of cash in banks and short-term investments with maturities less than 90 days, except that such instruments purchased with endowment and annuity and life income assets on deposit with trustees are classified as investments. Interest income allocated from the University is included in other gains (losses), net in the accompanying statements of operations and changes in net assets.

Inventory
Inventory consists of pharmaceuticals and medical supplies and is valued at the lower of cost (first-in, first-out) or market.

Equity Investments
The Hospital's equity investments include an investment in a captive insurance company (Note 5) which is recorded under the equity method.

Investments
The Hospital's investments are held as part of the University's consolidated investment pool, and are subject to the same asset allocation between stocks, debt securities, hedge funds and other investments as the overall University investment pool. The Hospital reports investments in equity and debt securities at fair value in the balance sheet based on quoted market prices of public securities markets. The fair value of other investments is based upon values reported by the respective investment managers and consists of readily marketable securities that may be less liquid than the University's other investments. Investment income or loss (including realized gains or losses on investments, interest, and dividends) is included in the excess of revenues over expenses, unless their use is restricted by donor stipulations or law. Unrealized gains and losses on investments are included in the operating measure as the investments are trading securities.

A decline in the market value of an investment security below its cost that is designated as other than temporary is recognized through an impairment charge. Impairment charges are included in excess of revenue over expenses in the statements of operations and changes in net assets and a new cost basis is established.

Assets Whose Use Is Limited
Assets whose use is limited is comprised of investments held by trustees in accordance with indenture agreements to be used for the acquisition of property and equipment and debt retirement. Assets whose use is limited also includes investments whose purpose is designated by the University of Rochester Medical Center Board (the "Board"). Investment income on assets whose use is limited is classified as other gains (losses), net in the accompanying statements of operations and changes in net assets.

Deferred Financing Costs
Deferred financing costs represent costs incurred in connection with the issuance of the Hospital's long-term debt. These costs are capitalized and amortized using the effective interest method over the term of the related borrowing. Accumulated amortization was approximately $603,000 and $499,000 at December 31, 2011 and 2010, respectively.

Property and Equipment

Property and equipment are recorded at cost. Donated property and equipment are recorded at estimated fair value at the date of receipt. The Hospital calculates depreciation using the straight-line method applied to the following useful lives:

Property and fixed equipment	3–50 years
Moveable equipment	3–20 years

The University owns the related land and land improvements, and as such, these assets are not recorded on the Hospital's financial statements. Costs to maintain these land and land improvements are charged to the Hospital based on various allocation methodologies.

Equipment under capital leases is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization.

Interest cost incurred on borrowed funds during the period of construction of property and equipment is capitalized as a component of the cost of acquiring those assets.

Long-Lived Assets

In the event circumstances indicate, the Hospital applies guidance related to the impairment or disposal of long-lived assets. Under the guidance, the Hospital reviews the carrying value of its long-lived assets, other than goodwill and purchased intangible assets with indefinite useful lives, if any, for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Hospital assessment would include an estimate of the undiscounted future cash flows that are directly associated with and that are expected to arise from the use of and eventual disposition of such asset group and if the carrying value of the asset group exceeded the estimated undiscounted cash flows, the Hospital would record an impairment charge to the extent the carrying value of the long-lived assets exceeds its estimated fair value.

In connection with its assessment of recoverability of its long-lived assets and its ongoing strategic review of the business and its operations, the Hospital continually reviews the remaining useful lives of its long-lived assets. If this review indicates that the remaining useful life of the long-lived assets has been reduced, the Hospital adjusts the depreciation on that asset to facilitate full cost recovery over its revised estimated remaining useful life. No such adjustment was made in 2011 or 2010.

Derivative Instruments and Hedging Activities

The Hospital's portion of derivative instruments related to the University's long-term debt is recorded as the fair value of interest rate swaps on the balance sheet. The change in the fair value of the derivative instruments is included in other gains (losses), net in the statement of operations and changes in net assets. The University selected the combination of variable rate bond issues and interest rate swap agreements to obtain fixed rate financing at the lowest available cost at the time of the transactions. The University is exposed to credit loss in the event of nonperformance by the counterparty to its long-term rate swaps. The interest rate swaps do not qualify for cash flow hedge accounting. All transactions related to interest rate swaps are classified in the accompanying statements of operations and changes in net assets.

Insurance Claims

The Hospital's provision for estimated professional liability and workers' compensation claims includes estimates of the ultimate costs for claims incurred, but not reported.

Self-insured professional liability and workers' compensation claim losses and expenses are recorded based upon management's estimate of losses associated with pending and probable claims. Loss estimates are derived from data developed by representatives of the Hospital's legal counsel, insurance company, physicians, insurance advisor, actuary, and management.

Benefit Plans
The Hospital participates in a University program which provides certain health care and life insurance benefits to retired employees and spouses under a defined benefit plan. These benefits include basic hospital, surgical and medical insurance, major medical insurance, dental assistance insurance, and group life insurance. Postretirement health care and other benefits are accounted for as a form of deferred compensation that is recognized over the service life of employees.

Postemployment benefits include benefits provided to former or inactive employees after employment but before retirement. Such benefits provided under the University program include workers' compensation benefits, short-term disability benefits and benefits provided under various other programs. See Note 10 for further discussion of benefit plans.

Donor-Restricted Gifts
Unconditional promises to give cash and other assets are reported at fair value at the date the promise 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 unrestricted net assets and reported in the statements of changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying statements of operations and changes in net assets.

University and Medical Center Cost Allocations
Costs incurred by the University and certain other Medical Center Divisions include administrative and support services and are allocated to the Hospital based on various allocation methodologies. Costs in this category include items such as human resources, information systems and security.

Income Taxes
The University is a not-for-profit organization as described in Section 501(c)(3) of the Internal Revenue Code and is generally exempt from income taxes on related income pursuant to Section 501(a) of the Code.

Asset Retirement Obligations
The Hospital accounts for asset retirement obligations in accordance with asset retirement and environmental obligations guidance. The Hospital accrues for asset retirement obligations in the period in which they are incurred if sufficient information is available to reasonably estimate the fair value of the obligation. Over time, the liability is accreted to its settlement value. Upon settlement of the liability, the Hospital will recognize a gain or loss for any difference between the settlement amount and liability recorded.

Charity Care and Provision for Bad Debts
As further described in Note 15, the Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue or patient accounts receivable.

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

Reclassifications
Certain amounts in previously issued financial statements have been reclassified to conform to the current year presentation.

2. Fair Value of Financial Instruments

The Hospital follows fair value measurements accounting, which defines fair value, establishes a framework of measuring fair value, and expands disclosures related to fair value measurements. Assets and liabilities recorded at fair value in the balance sheet are categorized based upon the level of judgment associated with the inputs used to measure their fair value. An asset or liability's categorization within the fair value hierarchy is based on the lowest level of judgment input to its valuation. Hierarchical levels are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities as follows:

Level 1 – Valuations are based on quoted prices in active markets for identical assets or liabilities that the Hospital has the ability to access. Such valuations are based on quoted prices that are readily and regularly available in active markets. Valuation of these products does not entail a significant degree of judgment.

Level 2 – Valuations are based on quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly.

Level 3 – Valuations are based on inputs that are unobservable and significant to the overall fair value measurement. These are generally company generated inputs and are not market based inputs.

The following tables present the financial instruments carried at fair value as of December 31, 2011 and 2010 on the balance sheet based on the valuation hierarchy defined above:

	2011			
	Investments	Assets Whose Use is Limited	Interest Rate Swaps	Total
Level 1	$ -	$ 30,950,339	$ -	$ 30,950,339
Level 2	45,496,793	4,160,570	15,652,027	65,309,390
Level 3	-	-	-	-
	$ 45,496,793	$ 35,110,909	$ 15,652,027	$ 96,259,729

	2010			
	Investments	**Assets Whose Use is Limited**	**Interest Rate Swaps**	**Total**
Level 1	$ -	$ 1,473,222	$ -	$ 1,473,222
Level 2	43,861,579	4,167,888	10,789,449	58,818,916
Level 3	-	-	-	-
	$ 43,861,579	$ 5,641,110	$ 10,789,449	$ 60,292,138

The valuation methods described below may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Hospital believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Fair value for Level 1 is based upon quoted market prices in active markets. Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers. Level 3 includes publicly traded stocks and bonds, and alternative investments (primarily limited partnership interests in absolute return, hedge, private equity, real estate, and natural resources funds), represent the ownership interest in the net asset value (NAV) of the respective partnership. Investments held by the partnerships consist of marketable securities as well as securities that do not have readily determinable fair values. The fair values of the securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner and are based on historical cost, appraisals, or other estimates that require varying degrees of judgment. If no public market exists for the investment securities, the fair value is determined by the general partner taking into consideration, among other things, the cost of the securities, prices of recent significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate.

Interest rate swaps are valued using both observable and unobservable inputs, such as quotations received from the counterparty, dealers or brokers, whenever available and considered reliable. In instances where models are used, the value of the interest rate swap depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability and reliability of observable inputs. Such inputs include market prices for reference securities, yield curves, credit curves, measures of volatility, prepayment rates, assumptions for nonperformance risk, and correlations of such inputs. The Hospital’s interest rate swap arrangements have inputs which can generally be corroborated by market data and are therefore classified within Level 2.

The following table is a rollforward of the balance sheet amounts for financial instruments classified by the Hospital within Level 3 of the valuation hierarchy defined above.

	Investments	Assets Whose Use is Limited
Fair value January 1, 2010	$ 41,750,822	$ 3,933,888
Transfers in	-	-
Transfers out	(41,750,822)	(3,933,888)
Realized and unrealized gains	-	-
Fair value December 31, 2010	-	-
Transfers in	-	-
Transfers out	-	-
Realized and unrealized gains	-	-
Fair value December 31, 2011	$ -	$ -

In accordance with new guidance related to the measurement of alternative investments, the Hospital reclassified its holdings in the University's endowment fund from Level 3 to Level 2 in 2010 as these holdings can be redeemed at any time.

3. Third Party Reimbursement

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare
Under the Medicare program, the Hospital receives reimbursement under a prospective payment system (PPS) for inpatient services. Under the hospital inpatient PPS, fixed payment amounts per inpatient discharge are established based on the patient's assigned diagnosis related group (DRG). When the estimated cost of treatment for certain patients is higher than the average and exceeds specified thresholds, providers typically will receive additional "outlier" payments. The Hospital also receives reimbursement under a prospective payment system for certain medical outpatient services, based on service groups, called ambulatory payment classifications (APCs). Other outpatient services are based upon a fee schedule and/or actual costs. The Hospital's Medicare cost reports are subject to audit by the fiscal intermediary and have been audited and final settled through December 31, 2005.

Medicaid and Other Third-Party Payors

The New York Health Care Reform Act of 1996 (HCRA), as amended, governs payments to hospitals in New York State through December 31, 2012. Under the Act, Medicaid, workers compensation and no-fault payors pay rates promulgated by the New York State Department of Health. Fixed payment amounts per inpatient discharge are established based on the patient's assigned case mix intensity similar to a Medicare DRG. All other third-party payors, principally Blue Cross, other private insurance companies, Health Maintenance Organizations (HMOs), Preferred Provider Organizations (PPOs) and other managed care plans, negotiate payment rates directly with the hospitals. Such arrangements vary from DRG-based payment systems, to per diems, case rates and percentage of billed charges. If such rates are not negotiated, then the payors are billed at the Hospital's established charges. Effective December 1, 2009, NYS implemented inpatient reimbursement reform. The reform updated the data used to calculate payment rates utilizing All Payor Revised DRGs (APR-DRGs). APR-DRGs used revised SIWs to adjust each APR-DRG for patient activity. Similar type outpatient reforms were implemented effective December 1, 2008 by connecting outpatient payments to Ambulatory Payment Groups (APGs) which use outpatient SIWs based on types of service and resource consumption.

In addition, under HCRA, all non-Medicare payors are required to make surcharge payments for the subsidization of indigent care and other health care initiatives. The percentage amounts of the surcharge vary by payor and apply to a broader array of health care services. Also, certain payors are required to provide additional funds through surcharges on payments to hospitals for inpatient services or through voluntary election to pay a covered lives assessment directly to the Department of Health. Through December 31, 2008, these additional payments were used to fund a pool for graduate medical education (GME) expenses. Beginning January 1, 2009, the GME pool was consolidated into the indigent care pool.

Revenue from Blue Cross and MVP Health Care accounted for approximately 29% and 6%, respectively, of the Hospital's net patient service revenue for the year ended December 31, 2011. Revenue from Blue Cross and MVP Health Care accounted for approximately 27% and 8%, respectively, of the Hospital's net patient service revenue for the year ended December 31, 2010.

Revenue from Medicare and Medicaid programs (including Medicare advantage and Medicaid managed care plans) accounted for approximately 31% and 18%, respectively, of the Hospital's net patient revenue for the year ended December 31, 2011. Revenue from Medicare and Medicaid programs (including Medicare advantage and Medicaid managed care plans) accounted for approximately 32% and 16%, respectively, of the Hospital's net patient revenue for the year ended December 31, 2010. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term. The Hospital believes that it is in compliance, in all material respects, with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation. Noncompliance with such laws and regulations could result in repayments of amounts improperly reimbursed, substantial monetary fines, civil and criminal penalties and exclusion from the Medicare and Medicaid programs.

Both Federal and New York State regulations provide for certain adjustments to current and prior years' payment rates and indigent care pool distributions based on industry-wide and hospital-specific data. The Hospital has established estimates based on information presently available of the amounts due to or from Medicare, Medicaid, workers compensation and no-fault payors and amounts due from the indigent care pool for such adjustments. Those adjustments which can be reasonably estimated have been provided for in the accompanying financial statements. The Hospital has estimated the potential impact of such adjustments based on the most recent information available. However, those which are either (a) without current specific regulations to implement such adjustments, or (b) are dependent upon certain future events, cannot be reasonably estimated and have not been provided for in the accompanying financial statements.

Management believes the amounts recorded in the accompanying financial statements will not be materially affected upon the implementation of such adjustments. During 2011, the Hospital recognized an increase of approximately $19,100,000 in net patient service revenue as a result of changes in estimates related to third party settlements. During 2010, the Hospital recognized a reduction of approximately $300,000. In addition, during 2011 and 2010, the Hospital recognized additional third-party payables of approximately $23,000,000 and $11,100,000 related to calendar years 2011 and 2010, respectively.

There are various other proposals at the Federal and New York State levels relating to Medicare and Medicaid, that could, among other things, reduce reimbursement rates, modify reimbursement methods and increase managed care penetration. The ultimate outcome of these proposals and other market changes cannot presently be determined.

4. Concentrations of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements. Concentrations of patient accounts receivable by payor classes at December 31 are as follows:

	2011	2010
Medicare	16 %	14 %
Medicaid	15	13
Blue Cross	28	24
MVP Health Care	10	11
Commercial insurance	12	13
Self-pay	13	17
All other	6	8
	100 %	100 %

5. Investment in Captive Insurance Company

The Hospital, together with other universities and teaching hospitals, has formed a captive insurance company (captive) to insure the professional liability risks of the shareholders. The Hospital's investment in the captive represents 20% of the voting rights; however, the dissolution provisions of the captive agreement indicate that the Hospital's financial participation (based on percentage of premiums paid) is approximately 8% of the financial results of the captive. Due to the Hospital's significant influence in the captive, the investment in the captive has been recorded under the equity method.

The Hospital's premiums are based on its professional liability experience and a shared risk factor with the other participants. Premiums are subject to retrospective adjustment based on, among other things, actual loss experience of the Hospital.

The most recent financial information for the captive is summarized below for the years ended December 31:

	2011 (audited)	2010 (audited)
Net earned premiums	$ 169,621,862	$ 210,377,244
Expenses	(214,202,446)	(244,235,046)
Investment income and realized gains on sales of marketable securities	48,183,001	43,927,297
Net income	3,602,417	10,069,495
Other comprehensive (loss) income	(33,110,353)	58,823,698
Comprehensive (loss) income	(29,507,936)	68,893,193
Net capital additions from shareholders	69,899,595	4,765,262
Change in shareholders' equity	$ 40,391,659	$ 73,658,455
Financial position		
Total assets	$ 2,566,269,232	$ 2,488,112,851
Total liabilities	2,297,209,029	2,259,444,307
Shareholders' equity	$ 269,060,203	$ 228,668,544

6. Investments

Assets Whose Use Is Limited
Assets whose use is limited is comprised of the following at December 31:

	2011	2010
By Board for property and equipment replacement, debt retirement, and other designated purposes		
Pooled investments, at fair value	$ 4,160,569	$ 4,167,888
Held by trustees under indenture agreements		
Cash and short-term investments, at fair value	23,491,792	1,290,125
United States Treasury obligations, at fair value	7,458,548	183,097
	30,950,340	1,473,222
Total assets whose use is limited	$ 35,110,909	$ 5,641,110

Investments

Investments, including investments held for long term purposes, are held as part of the University's consolidated endowment pool and are comprised of the following at December 31:

	2011	2010
Unrestricted investments, at cost	$ 28,705,201	$ 27,413,310
Temporarily restricted investments, at cost	2,177,182	1,862,312
Market value appreciation		
Of unrestricted investments	2,204,826	2,251,848
Of temporarily restricted investments	1,109,302	1,136,541
Of permanently restricted investments	6,579,929	6,495,775
	$ 40,776,440	$ 39,159,786
Permanently restricted investments, at contributed value	$ 4,720,353	$ 4,701,793

Investment income, gains and losses for assets whose use is limited, cash, other investments and interest rate swaps are comprised of the following for the years ended December 31:

	2011	2010
Included in other gains (losses), net		
Unrealized loss on interest rate swaps	$ (4,862,578)	$ (1,924,872)
Interest income	1,133,465	1,950,900
Net realized gains	777,485	1,239,437
Net unrealized (losses) gains	(94,409)	1,972,763
	$ (3,046,037)	$ 3,238,228
Included in temporarily restricted net asset change		
Net unrealized gains	$ 8,152	$ 712,364

7. Property and Equipment

Property and equipment is comprised of the following at December 31:

	2011	2010
Property and fixed equipment	$ 459,175,559	$ 448,301,452
Moveable equipment	321,590,844	270,405,024
	780,766,403	718,706,476
Less: Accumulated depreciation and amortization	(451,548,679)	(417,861,564)
	329,217,724	300,844,912
Construction in progress	41,004,386	39,804,210
Property and equipment, net	$ 370,222,110	$ 340,649,122

Construction in progress is made up of certain projects started but not completed at December 31, 2011, the most significant of which include the Cancer Center vertical expansion project, the ambulatory electronic medical record project, the Bone Marrow Transplant Unit relocation, various operating room upgrades and renovations, infrastructure projects, various patient unit renovations, and information technology upgrades. The estimated cost to complete these projects is $197,249,000. These costs are expected to be funded through a combination of philanthropy, external borrowing and hospital equity.

In 2011 and 2010, the Hospital capitalized interest costs incurred on borrowed funds during the period of construction of property and equipment of $569,376 and $221,660, respectively.

8. Long-Term Debt and Lease Arrangements

Long-term debt arrangements are entered into by the University, with amounts recorded by the Hospital based on its share of each respective debt issuance.

Long-term debt obligations consist of the following at December 31:

	2011	2010
Dormitory Authority of the State of New York (DASNY)		
Series 2003B	$ 28,375,000	$ 30,500,000
Series 2003C	47,205,000	51,080,000
Series 2006B	17,050,000	17,050,000
Series 2007B	39,327,388	40,039,656
Series 2009C	10,409,638	10,914,530
Series 2009D	1,987,499	2,922,239
Monroe County Industrial Development Corp (MCIDC)		
Series 2011B	41,348,702	-
	185,703,227	152,506,425
Less: Current installments of long-term debt	(8,515,000)	(8,010,000)
	$ 177,188,227	$ 144,496,425

DASNY - Series 2003B
Pursuant to an agreement between the University and DASNY dated November 6, 2003, DASNY issued and sold $49,650,000 of bonds, of which a portion was used to finance the expansion of the Parking Garage and various other Hospital capital projects and equipment. The Hospital is repaying the indebtedness over a 29-year period ending July 1, 2033 at an average interest rate of 3.97%. Series 2003B bonds also refinanced University of Rochester Series 1993A bonds and a portion of the University of Rochester Series 1994 bonds.

On September 3, 2008, the bond agreement for Series 2003B was restructured so that a more favorable interest rate could be obtained in current market conditions. The terms related to principal repayment did not change. The revenue bonds were reoffered at the outstanding principal balance of $34,350,000 as variable interest rate bonds. The bonds were converted from an auction rate to a daily interest rate as determined by the remarketing agent. The debt restructure included a letter of credit for liquidity issued by HSBC Bank in an amount totaling the outstanding debt service of the bond maturing on September 9, 2013.

DASNY - Series 2003C
Pursuant to an agreement between the University and DASNY dated November 6, 2003, DASNY issued and sold $82,225,000 of bonds, of which a portion was used to finance the construction of the Adult Intensive Care Unit and other Hospital capital projects and equipment. The Hospital is repaying the indebtedness over a 29-year period ending July 1, 2033 at an average interest rate of 3.97%. Series 2003C bonds also refinanced a portion of the University of Rochester Series 1994 bonds.

On September 10, 2008, the bond agreement for Series 2003C was restructured so that a more favorable interest rate could be obtained in current market conditions. The terms related to principal repayment did not change. The revenue bonds were reoffered at the outstanding principal balance of $58,240,000 as variable interest rate bonds. The bonds were converted from an auction rate to a weekly interest rate as determined by the remarketing agent. The debt restructure included a letter of credit for liquidity issued by JP Morgan Chase Bank in an amount totaling the outstanding debt service of the bond maturing on March 13, 2013.

DASNY - Series 2006B
Pursuant to an agreement between the University and DASNY dated March 16, 2006, DASNY issued and sold $17,050,000 of bonds which refinanced a portion of the University of Rochester Series 1999B bonds. The Hospital is repaying the indebtedness over a 19-year period ending June 30, 2024 at an average interest rate of 3.94%.

On September 10, 2008, the bond agreement for Series 2006B was restructured so that a more favorable interest rate could be obtained in current market conditions. The terms related to principal repayment did not change. The revenue bonds were reoffered at the outstanding principal balance of $17,050,000 as variable interest rate bonds. The bonds will bear a weekly interest rate as determined by the remarketing agent. The debt restructure included a letter of credit for liquidity issued by Bank of America in an amount totaling the outstanding debt service of the bond maturing on September 10, 2013.

DASNY - Series 2007B
Pursuant to an agreement between the University and DASNY dated February 21, 2007, DASNY issued and sold $40,290,000 of bonds whose proceeds were used for construction of the Hospital's portion of the Cancer Center building and equipment, renovation of surgical adult intensive and intermediate care units, renovation of the medical/surgical behavioral inpatient unit, and other Hospital capital projects and equipment. The Hospital is repaying the indebtedness over a 32-year period ending January 1, 2039 at rates of interest varying from 4.0% to 5.0%.

DASNY - Series 2009C
Pursuant to an agreement between the University and DASNY dated July 22, 2009, DASNY issued and sold $11,135,000 of bonds whose proceeds were used to finance the electrical switchgear relocation project. The Hospital is repaying the indebtedness over a 17-year period ending June 10, 2026 at rates of interest varying from 2.5% to 5.0%.

DASNY - Series 2009D
Pursuant to an agreement between the University and DASNY dated July 22, 2009, DASNY issued and sold $3,625,000 of bonds which refinanced the University of Rochester Series 1999B bonds. The Hospital is repaying the indebtedness over a 4-year period ending June 10, 2013 at rates of interest varying from 2.5% to 5.0%.

MCIDC – Series 2011B
Pursuant to an agreement between the University and MCIDC dated September 1, 2011, MCIDC issued and sold $39,320,000 of bonds whose proceeds were used to finance the Cancer Center vertical expansion, relocation of the Bone Marrow Transplant unit, the Operating Room air handler renovation and the replacement of angiography lab equipment. The Hospital is repaying the indebtedness over a 30-year period ending May 10, 2041 at rates of interest varying from 2.0% to 5%.

Scheduled principal repayments on long-term debt including unamortized premiums for the next five years are as follows:

2012	$ 8,515,000
2013	7,715,000
2014	8,515,000
2015	9,290,000
2016	9,890,000
Thereafter	141,778,227
	$ 185,703,227

The University has letter of credit agreements with various financial institutions to purchase the University's variable rate demand bonds in the event they cannot be remarketed. In the event that the bonds covered by these agreements were not remarketable and the agreements not otherwise renewed, the Hospital's allocated principal amounts due in the principal debt service payments table (including variable rate demand bonds not subject to liquidity facilitates) would be $8,708,410, $88,987,731, $1,639,972, $2,409,972, $2,504,972 and $81,452,170 for the five year period ending December 31, 2016 and thereafter.

On July 31, 2003 the University executed $164,425,000 of interest rate swaps with third parties related to the DASNY Series 2003 debt issuances. The University entered into interest rate swap agreements to exchange variable rate debt for a fixed rate obligation without the exchange of the underlying principal amount. Under these agreements, the counterparties pay the University a variable interest rate equal to 61.5% of one-month LIBOR plus 56 basis points. The University will pay the counterparties a fixed interest rate of 3.97%. Net payments or receipts under the swap agreements are recorded as an adjustment to interest expense by the University. The contractual relationship under these agreements will last until July 1, 2033. The University is obligated to make payments under the Series 2003 agreement. The Hospital is allocated its pro rata portion of these swaps based on its allocated share of the Series 2003 debt issuance.

On March 16, 2006 the University executed $111,180,000 of interest rate swaps with a third party related to the DASNY Series 2006 debt issuances. The University entered into an interest rate swap agreement to exchange variable rate debt for the fixed rate obligation without the exchange of the underlying principal amount. Under this agreement, the counterparty will pay the University a variable interest rate based on the Bond Market Association (BMA) Municipal Swap Index. The University will pay the counterparty a fixed interest rate of 3.92%. Net payments or receipts under the swap agreement are recorded as an adjustment to interest expense by the University. The contractual relationship under this agreement will last until July 1, 2027. The University is obligated to make payments under the Series 2006 agreement. The Hospital is allocated its pro rata portion of the swap based on its allocated share of the Series 2006 debt issuance.

For the years ended December 31, 2011 and 2010, the University recorded a net loss of $11,835,887 and $4,565,656, respectively and a related change in liabilities representing the fair value of the interest rate swap agreements. The Hospital's portion of the net loss was based on its share of the Series 2003 and Series 2006 debt issuances. For the years ended December 31, 2011 and 2010, the Hospital recorded a net loss of $4,862,578 and $1,924,872, respectively. This amount is included in other gains (losses), net on the statements of operations and changes in net assets.

The Hospital, either directly or through the University, also has several noncancelable operating leases, primarily for equipment and clinical and office space, that expire over the next twelve years. Rental expense for all operating leases was $19,099,993 and $18,190,999 for the years ended December 31, 2011 and 2010, respectively.

The Hospital's future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) at December 31, 2011 are:

2012	$ 9,804,791
2013	9,369,620
2014	8,505,273
2015	8,009,383
2016	7,348,637
Thereafter	32,191,068
Total minimum lease payments	$ 75,228,772

A summary of the Hospital's investment income on borrowed funds held by the trustee under bond and equipment loan agreements for the years ended December 31 is as follows:

	2011	2010
Investment income		
Capitalized	$ 29,653	$ 2,960
Credited to nonoperating gains	57	757
	$ 29,710	$ 3,717

9. Professional Liability Claims

The Hospital's coverage for professional liability insurance is provided under insurance policies obtained jointly with other universities and teaching hospitals. The primary layer of coverage as well as the buffer and self-insured layers of excess insurance, were written by MCIC Vermont, Inc. (A Risk Retention Group) formed and directed by the participating insured institutions. Multiple layers of excess insurance were purchased from several different insurance companies. The maximum coverage for the Hospital is $221,500,000 per claim. The per claim coverage amount at each of the five participating institutions has been tailored to their own experiences and exposures.

In 2011, the Hospital adopted the principles of insurance claim and recovery accounting for professional liability claims. This required liability claims and any anticipated insurance recoveries to be reported on a gross basis versus the previous practice of netting the recoveries against liability claims. The insurance claims receivable as calculated by the actuaries was approximately $43,692,000 as of December 31, 2011, along with a corresponding increase to the accrued professional liability costs. This amount was split between current and non-current based upon projected future payments on professional liability claims as determined by the actuaries.

Based on estimates provided by the actuaries retained by MCIC Vermont, Inc., the Hospital's obligation for incurred but not reported claims was approximately $30,720,000 and $34,069,000 as of December 31, 2011 and 2010, respectively, which has been recorded as a noncurrent liability. This amount has not been discounted.

10. Benefit Plans

Self-Insurance Plans

The University is self-insured for workers' compensation, disability and medical benefits. Liabilities for asserted and unasserted claims under the workers' compensation program at December 31, 2011 and 2010 were discounted by 2.0% and 3.25%, and amounted to $48,905,000 and $40,748,000, respectively. The Hospital's portion of this liability at December 31, 2011 and 2010 amounted to $30,601,000 and $25,353,000, respectively.

This liability is offset by a receivable for the expected insurance direct payment against these claims of $6,452,083 and $4,837,455 at December 31, 2011 and 2010, respectively.

The University has a $31.0 million standby letter of credit with JPMorgan Chase Bank to cover potential liabilities under the University's self-insured workers' compensation program.

The University is self-insured for health care benefits. Based on estimates provided by actuaries, the Hospital's portion of the University's obligation for incurred but not reported claims was $3,808,000 and $4,051,000 as of December 31, 2011 and 2010, respectively. This amount has not been discounted.

Retirement Plan

The University provides defined contribution retirement plans to employees in eligible positions. The University of Rochester's Retirement Program offers four investment company options that are administered by each of the separate investment companies. The University makes contributions to the plan after two years of service based on a percentage of the employee's salary which are immediately vested for the benefit of the participants. Hospital contributions to the plans amounted to approximately $24,272,000 and $22,364,000 for the years ended December 31, 2011 and 2010, respectively.

Postemployment Benefits

The Hospital participates in a postemployment benefit plan sponsored by the University. The Hospital has employed independent actuaries to estimate the postemployment benefit costs of the Hospital. Accrued postemployment benefits of the Hospital amounted to approximately $48,272,000 and $38,664,000 at December 31, 2011 and 2010, respectively. This amount is inclusive of workers' compensation, disability and medical benefits amounts as discussed above. The current portion of the postemployment benefits has been actuarially determined to be approximately $22,984,000 and $17,825,000 as of December 31, 2011 and 2010, respectively.

The Hospital's portion of the University's postemployment benefits expense was $7,993,000 and $2,802,000 for the years ended December 31, 2011 and 2010, respectively.

Postretirement Benefit Plan

The University's postretirement benefit plan includes basic medical, major medical, dental coverage and life insurance. Benefit levels differ for current retirees, current employees eligible to retire, and current employees not eligible to retire.

The Hospital's portion of the University's postretirement plan expense was $5,633,000 and $5,162,000 for the years ended December 31, 2011 and 2010, respectively.

The following table presents the plan's status recognized on a University wide basis, including the Hospital, using the actuarial valuation performed as of June 30:

	2011	2010
Change in benefit obligations		
Benefit obligation at beginning of year	$ 143,376,766	$ 125,596,402
Service cost	2,916,614	2,562,059
Interest cost	7,337,466	7,635,605
Estimated plan participants' contributions	2,013,000	1,654,011
Actuarial (gain) / loss	(8,032,521)	14,436,150
Benefits paid	(9,244,000)	(8,507,461)
Amendments	3,159,942	-
Benefit obligation at end of year	$ 141,527,267	$ 143,376,766
Change in plan		
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	7,231,000	6,853,450
Participant contributions	2,013,000	1,654,011
Benefits paid	(9,244,000)	(8,507,461)
Fair value of plan assets at end of year	$ -	$ -
Components of accrued benefit		
Funded status	$ (141,527,267)	$ (143,376,766)
Unrecognized net actuarial loss	18,678,191	27,662,484
Unrecognized prior service cost	8,863,433	10,822,256
Accrued benefit	$ (113,985,643)	$ (104,892,026)
Amounts recognized in the balance sheet consist of		
Accrued postretirement benefit cost	$ (104,892,026)	$ (96,381,426)
Net postretirement benefit expense	(16,324,617)	(15,364,050)
Net benefits paid	7,231,000	6,853,450
Accrued benefits paid at end of year	(113,985,643)	(104,892,026)
Amount recorded in unrestricted net assets	(27,541,624)	(38,484,740)
Net amount recognized in balance sheet	$ (141,527,267)	$ (143,376,766)
Components of net periodic benefit cost		
Service cost	$ 2,916,614	$ 2,562,059
Interest cost	7,337,466	7,635,605
Amortization of prior service cost	6,070,537	5,166,386
Net periodic benefit cost	$ 16,324,617	$ 15,364,050

Estimated future contributions, benefit payments, and 28% prescription drug subsidy payments, are as follows:

	Estimated Contributions/ Benefit Payments	Estimated 28% Rx Subsidy Payments
2012	$ 8,896,000	$ 1,018,000
2013	9,578,000	1,126,000
2014	10,143,000	1,156,000
2015	10,363,000	1,042,000
2016	10,491,000	1,063,000
2017 to 2021	53,721,000	2,428,000
Total estimated future payments	$ 103,192,000	$ 7,833,000

Benefits are valued based upon the projected unit cost method. The weighted average assumptions used at the measurement date, July 1, are as follows:

	2011	2010
Discount rate for obligation	5.25 %	5.25 %
Expected return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Health care cost trend rate - initial, pre-age 65	10.00 %	10.00 %
Health care cost trend rate - initial, post-age 65	8.00 %	10.00 %
Health care cost trend rate - final	4.50 %	4.50 %

The rate increase in healthcare costs was assumed to decrease to 4.5% in 2017 and to remain at that level thereafter. Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one percentage-point change in the health care cost trend rate would have the following effects (in thousands):

	One Percentage Point Increase	One Percentage Point Decrease
Effect on total of service and interest cost components	$ 627	$ (519)
Effect on postretirement benefit obligation	4,932	(4,227)

A single actuarial calculation is performed for all employees covered by the postretirement benefit plan. The components of net periodic postretirement benefit cost and the actuarial present values of postretirement benefit obligations are not calculated for the individual divisions of the University. Instead, total net periodic postretirement benefit cost is allocated to the individual divisions of the University. The Hospital's portion of the postretirement benefit liability of the University was recorded by the Hospital at December 31, 2011 and 2010 and amounted to $63,745,457 and $63,485,499, respectively.

The Medicare Prescription Drug Improvement and Modernization Act of 2003 provides for a direct government subsidy for employers who continue to offer a retiree drug program that is deemed to be actuarially equivalent in the government plan. The University qualified for the Medicare Part D prescription drug federal subsidy.

Employers are required to recognize the over-funded or under-funded status of a defined benefit pension and postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. In addition, employers are required to measure the funded status of the plan as of the balance sheet date.

11. Fair Value of Long-Term Debt

The fair value of the Hospital's long-term debt instruments is based on the amount of future cash flows discounted using the Hospital's current borrowing rate for similar debt instruments of comparable maturity.

The estimated fair value of the Hospital's long-term debt at December 31 is summarized as follows:

	2011		2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Series 2003B	$ 28,375,000	$ 27,403,506	$ 30,500,000	$ 28,441,886
Series 2003C	47,205,000	46,008,994	51,080,000	47,938,837
Series 2006B	17,050,000	16,522,900	17,050,000	15,742,966
Series 2007B	39,327,388	40,471,918	40,039,656	38,370,634
Series 2009C	10,409,638	10,224,219	10,914,530	10,235,000
Series 2009D	1,987,499	1,862,696	2,922,239	2,702,123
Series 2011B	41,348,702	41,374,794	-	-

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

12. Related Party and Inter-Divisional Transactions

The Hospital has a loan receivable from a related party. As of December 31, 2011 and 2010, the amount outstanding, including accumulated interest of $1,740,529, was $5,160,906. The terms of the loan include interest at 9.5% per annum through December 31, 2001. This loan receivable is fully reserved as of December 31, 2011 and 2010.

The Hospital guaranteed to cover a portion of the outstanding receivable balance on the books of Highland Hospital, which is due from Highlands at Brighton, in the event there is an insufficient cash flow from Highlands at Brighton over the five year period to repay. The Hospital's guarantee as of December 31, 2011 and 2010 was approximately $297,000 and $438,000, respectively.

Strong Partners Health System (SPHS) is the sole corporate member of Highland Hospital of Rochester, Highland Community Development Corporation, the Highlands Living Center, and the Highlands of Brighton. The University of Rochester is the sole corporate member of SPHS. The Hospital provides administrative services to SPHS. During the years ended December 31, 2011 and 2010, the Hospital charged SPHS approximately $2,509,000 and $2,681,000, respectively, for these services.

In addition, the Hospital purchases certain other administrative services from SPHS. During the years ended December 31, 2011 and 2010, the Hospital was charged approximately $4,627,000 and $2,929,000, respectively, for these services which are included on the statements of operations and changes in net assets.

In order to fulfill specific strategic initiatives of the Hospital and Medical Center, each year the Hospital funds, through inter-divisional transfers, certain capital and operating needs of other divisions of the Medical Center. These transfers include amounts for research and other strategic initiatives of the Medical Center. The transfers to the University of Rochester Medical Center Divisions were approximately $34,154,000 and $29,697,000 for the years ended December 31, 2011 and 2010, respectively. The Hospital has recorded a current liability for unpaid transfers and clinical support due to other University of Rochester divisions of $19,228,632 and $14,235,111 as of December 31, 2011 and 2010, respectively.

Beginning in September 2010, the Hospital began to fund certain capital costs of the Medical Faculty Group division of the University (URMFG) related to the ambulatory electronic health record project. The funds are loaned to URMFG based on actual costs incurred, up to a maximum of $10,658,000 until federal stimulus funding is received to repay the loan in 2013. The loan balance as of December 31, 2011 and 2010 was $1,848,750 and $686,691, respectively, and is reported in other noncurrent assets on the balance sheets.

In 2011, the Hospital recorded a loan receivable from the Health Sciences Division of the University (HSD) for their purchase of a medical building. HSD is repaying the loan over a 10-year period ending October 2021 at an interest rate of 1.0%. As of December 31, 2011, the balance outstanding was $10,813,043 which is reported in other current and noncurrent assets on the balance sheets.

As of December 31, 2011 and 2010, the Hospital has recorded a liability to the University in the amount of $0 and $757,297, respectively, related to the allocation of certain costs for an upgrade of the University's IT network infrastructure.

13. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at December 31:

	2011	2010
Construction, renovations and purchase of equipment	$ 21,798,069	$ 1,762,639
Specific acute hospital costs	3,806,664	6,524,531
Research	183,444	183,444
Other	6,873,700	3,584,626
	$ 32,661,877	$ 12,055,240

Permanently restricted net assets are restricted to the following purpose at December 31:

	2011	2010
Investments to be held in perpetuity, the income from which is expendable to support health care services	$ 4,720,353	$ 4,701,793

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes of the following for the years ended December 31:

	2011	2010
Hospital operations	$ 608,092	$ 382,459
Construction, renovations and purchase of equipment	476,408	1,333,879
	$ 1,084,500	$ 1,716,338

14. Endowment Net Assets

On September 17, 2010, the New York Prudent Management of Institutional Funds Act (NYPMIFA) was adopted. In accordance with the guidance provided under NYPMIFA, the University's Board of Trustees instructed the University to adopt a methodology designed to avoid spending below the historical dollar value of donor-restricted (true) endowment funds, absent explicit donor direction to the contrary. As a result, permanently restricted net assets are classified at the original gift value of true endowments plus any subsequent gifts and accumulations made in accordance with the directions of the applicable gift instruments. The portion of true endowment funds that is not classified as permanently restricted net assets is classified as temporarily restricted net assets in accordance with these accounting standards. To conform to these standards, for the year ended December 31, 2010 the Hospital reclassified $1,306,710 of accumulated unspent appreciation on true endowment funds from unrestricted to temporarily restricted net assets and recorded this as a cumulative effect of a change in accounting principle.

The University's Board of Trustees interprets NYPMIFA to allow for the spending of income and gains on investments of permanently restricted net assets in a manner that is prudent, considering such factors as the duration and preservation of the endowment fund, general economic conditions including the potential effect of inflation or deflation, the expected total return of the fund, other resources of the University, the needs of the University and the fund to make distributions and preserve capital, and the University's investment policy.

Investment of the Hospital's net assets held for endowment and similar purposes is based upon a total return policy, and the utilization of its endowment resources for current operating and capital needs as related to this policy. Although NYPMIFA does not preclude the University from spending below the original gift value of permanently restricted funds, the University's policy is to spend no more than a stated percentage of fair value of its investment portfolio over time. To the extent that the total return requirement for the current year is not fulfilled by interest and dividends, the University utilizes the appreciation of its endowment and similar net assets for operating purposes. To the extent that the total return requirement for the current year is exceeded by interest and dividends, the University reinvests the excess in its net assets held for endowment and similar purposes.

The University, in compliance with NYPMIFA, notified available donors who had established endowments prior to September 17, 2010 of the new law, and offered these donors the option of requiring the University to maintain historical dollar value for their endowment funds. A minority of donors requested this option; for those who did, the University has designed procedures to ensure that the University maintains historical dollar value.

Endowment net assets consist of the following at December 31, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Board-Designated Funds	$ 24,987,240	$ -	$ -	$ 24,987,240
Donor-Restricted Funds				
True Endowments	-	8,785,295	4,720,353	13,505,648
Term Endowments	-	469,262	-	469,262
Total Endowment Funds	$ 24,987,240	$ 9,254,557	$ 4,720,353	$ 38,962,150

Rollforward of endowment net assets from January 1, 2011 to December 31, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, January 1, 2011	$ 10,219,434	$ 9,055,691	$ 4,701,793	$ 23,976,918
Investment return				
Investment income	149,245	45,120	-	194,365
Net appreciation (depreciation)	(581,439)	8,153	-	(573,286)
Total investment return	(432,194)	53,273	-	(378,921)
New gifts	200,000	318,516	18,560	537,076
Other changes and reclassifications	15,000,000	(172,923)	-	14,827,077
Endowment net assets, December 31, 2011	$ 24,987,240	$ 9,254,557	$ 4,720,353	$ 38,962,150

Endowment net assets consist of the following at December 31, 2010:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Board-Designated Funds	$ 10,219,434	$ -	$ -	$ 10,219,434
Donor-Restricted Funds				
True Endowments	-	8,674,041	4,701,793	13,375,834
Term Endowments	-	381,650	-	381,650
Total Endowment Funds	$ 10,219,434	$ 9,055,691	$ 4,701,793	$ 23,976,918

Rollforward of endowment net assets from January 1, 2010 to December 31, 2010:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, January 1, 2010	$ 10,446,572	$ 6,993,052	$ 4,620,612	$ 22,060,236
Investment return				
Investment income	175,541	39,551	-	215,092
Net appreciation	902,026	714,368	-	1,616,394
Total investment return	1,077,567	753,919	-	1,831,486
New gifts	-	97,859	81,181	179,040
Amounts appropriated for expenditure	-	(114,410)	-	(114,410)
Other changes and reclassifications	(1,304,705)	1,325,271	-	20,566
Endowment net assets, December 31, 2010	$ 10,219,434	$ 9,055,691	$ 4,701,793	$ 23,976,918

15. Uncompensated Care

The Hospital's policy is to treat patients in need of medical services without regard to their ability to pay for such services. The Hospital maintains records to identify and monitor the level of uncompensated care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. In addition to charity care, the Hospital also provides services at rates significantly below the cost of rendering those services. The estimated difference between the cost of services provided to Medicaid patients and the reimbursement from the State for this patient care is also monitored.

Effective January 1, 2007, the New York State Public Health Law required all hospitals to implement financial aid policies and procedures. The law also required hospitals to develop a summary of its financial aid policies and procedures that must be made publicly available. All standards set forth in the law are minimum standards.

In order to qualify for charity care, patients are expected to submit financial information demonstrating need. In many cases, patients may be unable or unwilling to provide that data. In those cases, the uncompensated care is classified as bad debt expense unless the Hospital is able to obtain information that would indicate the patient appears to be eligible for charity care assistance. In those cases the uncompensated care is recorded as charity care.

Of the Hospital's $1,048,655,182 and $1,005,938,509 of total expenses reported in 2011 and 2010, respectively, an estimated $16,307,596 and $9,106,532 arose from providing services to patients who qualified for charity care. The estimated costs of providing charity services is based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The Hospital received funding from NYS to help defray some of the costs of indigent care in the amount of $8,459,857 and $9,028,372 in 2011 and 2010, respectively.

During the years ended December 31, 2011 and 2010, the following levels of uncompensated care were provided:

	2011	2010
Charity care at cost	$ 16,307,596	$ 9,106,532
Excess of cost over reimbursement for services provided to Medicaid patients	39,111,928	36,968,904
Bad debts expense	12,217,598	19,915,930
	$ 51,329,526	$ 56,884,834

16. Functional Expenses

The Hospital provides tertiary and general health care services to residents within its geographic location, including pediatrics, obstetrics, psychiatry, rehabilitation, cardiology, outpatient surgery, and liver and bone marrow transplantation. Expenses relating to providing these services are as follows for the years ended December 31:

	2011	2010
General service	$ 417,053,562	$ 409,879,638
Ancillary service	364,181,180	369,134,442
Inpatient routine service	142,424,525	134,768,099
Outpatient service	124,995,915	92,156,330
	$ 1,048,655,182	$ 1,005,938,509

17. Commitments and Contingencies

In the ordinary course of operations, the Hospital is named as a defendant in various lawsuits, or events occur which could lead to litigation, claims, or assessments. Although the outcome of such matters cannot be predicted with certainty, management believes that insurance coverage is sufficient to cover current or potential claims, or that the final outcomes of such matters will not have a material adverse effect on the financial position.

18. Subsequent Events

The Hospital has performed an evaluation of subsequent events through May 22, 2012, the date on which the financial statements were issued.