KPMG

KALEIDA HEALTH

Consolidated Financial Statements

December 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

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KPMG LLP
515 Broadway
Albany, NY 12207-2974

Independent Auditors' Report

The Board of Directors
Kaleida Health:

We have audited the accompanying consolidated balance sheets of Kaleida Health (Kaleida) as of Decembers 31, 2010 and 2009, 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 Kaleida'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 Kaleida'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 Kaleida Health as of December 31, 2010 and 2009, and the results of their operations and changes in net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

April 26, 2011

KALEIDA HEALTH

Consolidated Balance Sheets

December 31, 2010 and 2009

(Dollars in thousands)

Assets		2010	2009
Current assets:			
Cash and cash equivalents	$	60,122	70,050
Investments (notes 6 and 7)		148,795	149,803
Accounts receivable:			
Patient, less estimated allowance for doubtful accounts of $35,494 in 2010 and $40,527 in 2009 (note 3)		151,456	138,430
Other		8,291	7,748
Inventories		23,419	23,364
Prepaid expenses and other current assets		10,668	8,939
Total current assets		402,751	398,334
Assets limited as to use (notes 5, 6, 7, and 9):			
Designated under debt and lease agreements		50,831	50,685
Designated under self-insurance programs		138,592	128,758
Board designated and donor restricted		85,741	81,489
Other		1,380	1,589
		276,544	262,521
Property and equipment, less accumulated depreciation and amortization (notes 8 and 9)		351,188	282,379
Receivable for insurance recoveries (note 5)		7,809	7,678
Grants receivable (note 2)		47,143	54,987
Deferred financing costs, net		12,933	14,045
Other		6,321	4,955
Total assets	$	1,104,689	1,024,899

See accompanying notes to consolidated financial statements.

Liabilities and Net Assets		2010	2009
Current liabilities:			
Accounts payable and other accrued expenses	$	91,615	76,718
Accrued payroll and related expenses		54,216	50,079
Line of credit (note 9)		10,000	6,000
Estimated third-party payor settlements (note 4)		27,499	41,283
Current portion of long-term debt (note 9)		18,889	18,678
Other current liabilities		4,427	5,543
Total current liabilities		206,646	198,301
Long-term debt, less current portion (note 9)		226,544	216,153
Construction costs payable (note 9)		11,696	5,083
Estimated self-insurance reserves (note 5)		160,516	153,821
Asset retirement obligations (note 12)		10,685	10,217
Other long-term liabilities (note 11)		179,776	162,703
		589,217	547,977
Total liabilities		795,863	746,278
Commitments and contingencies (notes 8, 10, and 15)			
Net assets:			
Unrestricted		180,453	143,864
Temporarily restricted (note 13)		112,973	115,208
Permanently restricted (note 13)		15,400	19,549
Total net assets		308,826	278,621
Total liabilities and net assets	$	1,104,689	1,024,899

KALEIDA HEALTH

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2010 and 2009

(Dollars in thousands)

		2010	2009
Operating revenue:			
Net patient service revenue (notes 3 and 4)	$	1,180,088	1,145,164
Other operating revenue (note 6)		17,982	19,035
Net assets released from restrictions for operations (note 13)		7,703	9,373
Total operating revenue		1,205,773	1,173,572
Operating expenses:			
Salaries and benefits		668,426	632,609
Purchased services, supplies, and other		433,440	424,644
Depreciation and amortization		52,718	59,717
Provision for bad debts (note 3)		19,759	29,441
Interest		12,662	12,983
Total operating expenses		1,187,005	1,159,394
Income from operations		18,768	14,178
Other income (losses):			
Investment income (note 6)		12,339	8,700
Net realized losses on sales of investments (note 6)		(189)	(6,870)
Net change in unrealized gains and losses on investments (note 6)		14,917	41,312
Loss on impairment and disposal of assets (note 8)		(3,409)	(20,394)
Total other income, net		23,658	22,748
Excess of revenue over expenses	$	42,426	36,926

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KALEIDA HEALTH

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2010 and 2009

(Dollars in thousands)

		2010	2009
Unrestricted net assets:			
Excess of revenue over expenses	$	42,426	36,926
Pension and postretirement related changes other than net periodic cost (note 11)		(32,529)	20,224
Contributions for capital acquisitions		2,064	558
Net assets released from restrictions for property acquisitions		24,582	11,476
Other transfers, net (note 2 (n))		46	(10)
Increase in unrestricted net assets		36,589	69,174
Temporarily restricted net assets:			
Contributions, bequests, and grants (notes 2(j) and 8)		18,602	76,697
Restricted investment gains (losses)		1,023	(98)
Net change in unrealized gains and losses on investments		6,318	8,989
Net assets released from restrictions for operations		(7,650)	(9,373)
Net assets released from restrictions for property acquisitions		(24,582)	(11,476)
Other transfers, net (note 2(n))		4,054	(263)
(Decrease) increase in temporarily restricted net assets		(2,235)	64,476
Permanently restricted net assets:			
Contributions		4	—
Restricted investment losses		—	(273)
Net change in unrealized gains and losses on investments		—	4,495
Net assets released from restrictions for operations		(53)	—
Other transfers, net (note 2(n))		(4,100)	273
(Decrease) increase in permanently restricted net assets		(4,149)	4,495
Change in net assets		30,205	138,145
Net assets, beginning of year		278,621	140,476
Net assets, end of year	$	308,826	278,621

See accompanying notes to consolidated financial statements.

KALEIDA HEALTH

Consolidated Statements of Cash Flows

Years ended December 31, 2010 and 2009

(Dollars in thousands)

		2010	2009
Operating activities:			
Change in net assets	$	30,205	138,145
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		52,718	59,717
Accretion expense		713	773
Loss on impairment and disposal of assets		3,409	20,394
Restricted contributions, bequests, and grants		(12,661)	(66,738)
Change in receivable for insurance recoveries		(131)	(1,869)
Change in interests in limited partnerships		(9,484)	(5,395)
Net change in unrealized gains and losses on investments		(21,235)	(54,796)
Provision for bad debts		19,759	29,441
Pension and postretirement related changes other than net periodic cost		32,529	(20,224)
Change in operating assets and liabilities:			
Patient accounts receivable		(32,785)	(36,897)
Other receivables, inventories, and prepaid expenses		(2,327)	4,500
Accounts payable, accrued expenses, and accrued payroll		17,683	10,149
Estimated third-party payor settlements		(13,784)	20,374
Other assets		(1,366)	999
Other liabilities		(10,123)	11,849
Net cash provided by operating activities		53,120	110,422
Investing activities:			
Additions to property and equipment, net of change in construction costs payable		(112,821)	(72,032)
Net sales (purchases) of investments		17,704	(14,966)
Net cash used by investing activities		(95,117)	(86,998)
Financing activities:			
Principal payments on debt and capital lease obligations		(18,968)	(21,094)
Proceeds from restricted contributions, bequests, and grants		20,506	11,751
Proceeds from long-term debt		29,433	11,647
Net proceeds from line of credit		4,000	6,000
Increase in deferred financing fees		(2,902)	(3,675)
Net cash provided by financing activities		32,069	4,629
Net (decrease) increase in cash and cash equivalents		(9,928)	28,053
Cash and cash equivalents, beginning of year		70,050	41,997
Cash and cash equivalents, end of year	$	60,122	70,050
Supplemental disclosures on cash flow activities:			
Capital lease obligations	$	137	1,495
Interest paid		12,156	12,950
Capital acquisitions included in accounts payable		17,106	15,755

See accompanying notes to consolidated financial statements.

(1) Organization

Kaleida Health (Kaleida) is an integrated healthcare delivery system that provides acute, skilled nursing, rehabilitative, outpatient, and home healthcare services primarily to the residents of Western New York. The entities consolidated within Kaleida are the Hospital Corporation (Buffalo General Hospital, Women and Children's Hospital, the Millard Fillmore Hospitals, DeGraff Memorial Hospital, and three hospital based nursing facilities), Waterfront Health Care Center, Visiting Nursing Association of WNY, Inc., VNA Home Care Services, Inc., several other wholly owned subsidiaries, and two charitable foundations that raise funds for Kaleida.

In 2006, the Commission on Health Care Facilities in the 21st Century (Berger Commission) created by the Governor and New York State Legislature issued recommendations on health care capacity and resources in New York State. The Berger Commission report discussed, among other things, the context and process under which the recommendations were made, the authority granted to the NYS Department of Health (DOH) to implement the recommendations, and how the implementation of these recommendations may be timed and funded. The Berger Commission's recommendations included consolidation, closures, conversions, and restructuring of hospital and nursing home systems throughout New York State, including at Kaleida.

In connection with the recommendations issued by the Berger Commission, Kaleida has undertaken the development of a global heart vascular institute (GHVI) located adjacent to Buffalo General Hospital, and developed plans to carry out the closure and relocation of services from Millard Fillmore Gates Hospital (Gates) to the Buffalo General Hospital campus within a period of twenty-four months. During 2009, Kaleida received all the necessary approvals and funding to move forward with the GHVI. Notes 8 and 9 provide additional information related to the GHVI construction and financing.

Also, Kaleida and Erie County Medical Center Corporation (ECMCC), pursuant to a recommendation of the Berger Commission, agreed contractually in June 2008 to subordinate certain planning activities and quality improvement programs to Great Lakes Health, a stand-alone not-for-profit 501(c) 3 corporation.

(2) Summary of Significant Accounting Policies

(a) *Basis of Presentation*

The accompanying consolidated financial statements of Kaleida are presented consistent with the Financial Accounting Standards Board (FASB) *Accounting Standards Codification (ASC) 954, Health Care Entities,* (ASC 954), which addresses the presentation of financial statements for health care entities. In accordance with the provisions of ASC 954, 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 amounts not subject to donor-imposed stipulations and are available for operations. Temporarily restricted net assets are restricted by donors and are reflected as net assets released from restrictions in unrestricted net assets to the extent utilized during the period. Permanently restricted net assets are subject to the restrictions of gift instruments requiring that the principal be maintained in perpetuity while permitting the income to be utilized for general and specific purposes.

All significant intercompany transactions between Kaleida and its subsidiaries have been eliminated in consolidation.

Kaleida considers events or transactions that occur after the consolidated balance sheet date, but before the consolidated financial statements are issued, to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. These consolidated financial statements were available to be issued on April 26, 2011 and subsequent events have been evaluated through that date.

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The most significant areas which are affected by the use of estimates include the allowance for doubtful accounts, estimated third-party payor settlements, self-insurance reserves, valuation of certain alternative investments, and pension obligations. Actual results could differ from those estimates, and the differences in estimates from actual results could be significant.

(c) Cash and Cash Equivalents

Cash equivalents include amounts invested in short-term interest-bearing accounts and highly liquid debt instruments with original maturity dates of three months or less. For purposes of the consolidated statements of cash flows, cash equivalents exclude amounts maintained within investment portfolios and amounts classified as assets limited as to use.

Kaleida invests cash in money market securities and maintains cash balances in financial institutions in excess of federal deposit insurance limits. As discussed in note 2(o), cash equivalents available for operating purposes are at fair value using Level 1 measurement.

(d) Charity Care and Provision for Bad Debts

Kaleida provides care to patients who meet certain criteria under its charity care policies without charge or at amounts less than their established rates. Because Kaleida does not anticipate collection of amounts determined to qualify as charity care, they are not reported as revenue.

Kaleida grants credit without collateral to patients, most of whom are local residents and are insured under third-party arrangements. Additions to the estimated allowance for doubtful 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.

(e) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Revenue under certain third-party payor

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agreements is subject to audit and retroactive adjustment. Provision for estimated third-party payor settlements and adjustments are estimated in the period the related services are rendered and adjusted in future periods as final settlements are determined (note 4).

(f) Investments and Investment Income

Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing participants at the measurement date. See notes 2(o) and 7 for a discussion of fair value measurements.

Participation units in pooled investment funds held within unrestricted, temporarily restricted, and permanently restricted net assets are determined monthly based on the fair value of the underlying investments at the calculation date. Income earned on pooled investments is allocated to participating funds based on their respective unit shares of the pool.

Investment income or loss (including interest, dividends, realized gains and losses on investments, change in interest in limited partnerships, and change in unrealized gains and losses) is included in excess of revenue over expenses, unless the income is restricted by the donor or law. Further, investment income from funds designated for self-insurance programs and debt and lease agreements are recorded as a component of operating revenue.

(g) Inventories

Inventories consist principally of pharmaceutical and other medical supplies and are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

(h) Assets Limited as to Use

Assets limited as to use include investments maintained by a trustee under irrevocable self-insurance agreements and cash and investments held by trustees pursuant to debt agreements. Assets limited as to use also include investments set aside by the board of directors for specific purposes, as well as investments restricted by donors and grantors for a specific time period or purpose.

(i) Property and Equipment

Property and equipment are recorded at cost, except for donated items, which are recorded at fair market value at the date of donation. Cost includes interest incurred on related indebtedness during periods of construction. The costs of routine maintenance and repairs are charged to expense as incurred.

Kaleida monitors its long-lived assets for impairment indicators on an ongoing basis. If impairment indicators exist, Kaleida performs the required analysis and records impairment charges. In conducting its analysis, Kaleida compares the undiscounted cash flows expected to be generated from the long-lived assets to the related net book values. If the undiscounted cash flows exceed the net book value, the long-lived assets are considered not to be impaired. If the net book value exceeds the undiscounted cash flows, an impairment loss is measured and recognized based on the fair value of the asset, less costs to sell, or discounted cash flows compared to book value.

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Depreciation is generally computed under the straight line method using the half-year convention over the estimated useful lives of the assets. The estimated useful lives of assets generally follow American Hospital Association guidelines: land improvements, 10 years, buildings, fixtures, and improvements, 10 to 40 years, and movable equipment, 3 to 15 years. Assets recorded as capital leases are amortized over the lease term of the asset or its useful life, if shorter. Lease amortization is included within depreciation and amortization expense.

(j) Grants Receivable

During 2006 and 2008, Kaleida was awarded two grants totaling $74.7 million from the New York State Department of Health (DOH), through the Health Care Efficiency and Affordability Law for New Yorkers program (HEAL NY). The grants were awarded in order to fund the implementation of the recommendations made by the Berger Commission. During 2009 a Grant Disbursement Agreement for $65 million was finalized with DOH and Kaleida incurred expenditures and received funds under the grant to support the GHVI project. During 2010 a Grant Disbursement Agreement for $12.4 million was finalized with DOH to support the construction of a new skilled nursing facility. At December 31, 2010, $9.7 million of the total award was approved for construction and equipment by DOH, with the remaining $2.7 million approved in February 2011. The grant proceeds will be spent for the GHVI and skilled nursing facility project through December 31, 2011.

(k) Deferred Financing Costs

Kaleida has capitalized various costs associated with obtaining long-term financing. These costs are being amortized over the terms of related obligations.

(l) Self-Insured Programs

Certain divisions of Kaleida are partially self-insured for medical malpractice, general liability, and workers' compensation costs, with excess liability policies for exposures in excess of self-insurance retentions. Trusts have been established for the purpose of setting aside assets. Under the trust agreements, the trust assets can be used only for payment of losses, related expenses, and the costs of administering the trust.

Kaleida is also self insured for employee health coverage. Kaleida has recorded a provision for estimated claims which is based on Kaleida's own experience and includes the estimated cost of reported claims and claims incurred but not yet reported. To reduce its risk for catastrophe health claims, Kaleida has purchased stop loss coverage.

(m) Donor Contributions

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 limiting 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 to unrestricted net assets and reported as net assets released from restrictions and included as a component of total operating revenue, if for operations, or as an addition to unrestricted net assets, if for capital purposes. Contributions whose restrictions lapse, expire, or are otherwise met in the same reporting period as the contribution was received are recorded as unrestricted support and included as additions to unrestricted net assets.

(n) ***Endowment Funds***

Kaleida's permanently restricted net assets consist of individual endowment funds established by donors to support a variety of purposes.

In September 2010, New York State enacted the New York Prudent Management of Institutional Funds Act (NYPMIFA or Act), its version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), to provide clear standards of fund management for those charged with governance of institutional or endowment funds. NYPMIFA updates various provisions of prior New York State law governing fund management. The Act requires covered organizations to take specific actions with respect to appropriation from endowment funds and investment of institutional funds, including adoption of a written investment policy; diversification of investments; and adherence to a specified process to lift donor restrictions, allowable in certain limited circumstances. The Act permits an institution to determine the appropriate level of endowment expenditure, subject to donor-imposed restrictions expressed in the gift instrument. It establishes a rebuttable presumption of imprudence, however, if such expenditure in any year is greater than 7% of the fair market value of an endowment fund established by a gift instrument entered into on or after the effective date of the Act.

Kaleida classifies as permanently restricted net assets (a) the original value of gifts donated to an endowment fund, (b) the original value of subsequent gifts to that fund, and (c) accumulations to the fund made in accordance with the direction, if any, of the applicable donor gift instrument at the time the accumulation is added to the fund. Expendable portions of endowment gifts restricted by donors to specific purposes and any retained income and appreciation thereon is included as a component of temporarily restricted net assets. When the temporary restrictions on these assets have been met, the assets are reclassified to unrestricted net assets pursuant to Kaleida's spending policy.

The enactment and subsequent adoption of NYPMIFA resulted in a reclassification of approximately $4,100,000 between permanently restricted and temporarily restricted net assets on Kaleida's consolidated financial statements as of December 31, 2010.

(o) ***Fair Value Measurement of Financial Instruments***

Kaleida estimates fair value based on a valuation framework that uses a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy as defined by ASC 820, *Fair Value Measurements and Disclosures*, are described below:

Level 1: Quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities.

Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly and fair value is determined through the use of models or other valuation methodologies.

Level 3: Unobservable inputs that are supported by little or no market activity and require significant management judgment or estimation in the determination of fair value.

Kaleida also applies the accounting provisions of Accounting Standards Update (ASU) 2009-12, *Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalents) (ASU 2009-12).* ASU 2009-12 allows for the estimation of the fair value of investments in certain investment companies for which the investment does not have a readily determinable value by using net asset value (NAV) per share or its equivalent as a practical expedient.

The carrying values of accounts receivable, prepaid expenses and other current assets, accounts payable and line of credit are reasonable estimates of their fair value due to the short-term nature of these financial instruments. Kaleida's long-term debt instruments are carried at cost. Fair values are estimated based on quoted market prices for the same or similar issues. The estimated fair value of Kaleida's long-term debt as of December 31, 2010 and 2009 is approximately $234.8 million and $222.4 million, respectively. The value of debt was estimated by a discounted cash flow analysis using current borrowing rates for similar types of arrangements. Judgment is required in certain circumstances to develop the estimates of fair value, and the estimates may not be indicative of the amounts that could be realized in a current market exchange.

(p) Income Taxes

Kaleida and substantially all of its affiliates have been determined by the Internal Revenue Service to be organizations described in Internal Revenue Code (the Code) Section 501(c)(3) and, therefore, are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Kaleida recognizes income tax positions when it is more-likely-than-not that the position will be sustainable based on the merits of the position. Management has concluded that there are no material tax liabilities that need to be recorded.

(q) Excess of Revenue over Expenses

Kaleida's primary mission is meeting the healthcare needs of the people in the regions in which it operates. Kaleida is committed to providing a broad range of general and specialized healthcare services, including inpatient acute care, long-term care, home care, outpatient services, and other healthcare related services.

The consolidated statements of operations and changes in net assets include a performance indicator, excess of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess of revenue over expenses consistent with industry practice include contributions of long-lived assets, and pension and postretirement related changes other than net periodic cost.

For purposes of display, transactions deemed by management to be recurring, major or central to the provision of healthcare services, including unrestricted contributions and interest and dividends from funds designated for self-insurance programs and debt and lease agreements, are reported as operating revenue and expenses in the determination of Kaleida's operating results. Investment trading activities and peripheral transactions (i.e. impairment charges for Berger Commission restructuring and gains and losses related to disposal of fixed assets) are reported as other income or losses.

(r) Reclassifications

Certain amounts in the 2009 consolidated financial statements have been reclassified to conform to 2010 presentation.

(3) Uncompensated Care (Unaudited)

Kaleida accepts all patients regardless of their ability to pay. A patient's care may be classified as charity care in accordance with certain established policies of Kaleida. Essentially, these policies define charity services as those services for which no payment is anticipated. In addition, Kaleida serves the largest Medicaid and indigent patient population in Western New York whose healthcare service is only partially paid for by the Medicaid program.

On April 1, 2010, Kaleida implemented a presumptive charity scoring system in order to determine charity care eligibility. The system uses demographic and public financial information to qualify patient accounts for charity care. The change was made to enhance and accelerate the charity care qualification process which has resulted in an increase in charity care and a reduction in accounts sent to bad debt.

The following table summarizes uncompensated care provided during the years ended December 31:

		2010	2009
		(Dollars in thousands)	
Charity care excluded from revenue, based on established rates for services provided	$	17,686	8,390
Revenue shortfall compared to expenses for services provided to Medicaid and indigent patients		71,721	67,099
	$	89,407	75,489

Kaleida also provided additional uncompensated services of approximately $19.8 million and $29.4 million in 2010 and 2009, respectively, representing uncollectible patient accounts.

(4) Third-Party Reimbursement Agreements

Kaleida has agreements with third-party payors that provide for payments at amounts different from their established rates as follows:

(a) Inpatient Acute Care Services

Inpatient acute care services rendered are paid at prospectively determined rates per discharge in accordance with the Federal Prospective Payment System (PPS) for Medicare and generally at negotiated or otherwise pre-determined amounts under the provisions of the New York Health Care Reform Act (HCRA) for Medicaid and other Non-Medicare payors. Inpatient nonacute services are paid at various rates under different arrangements with third-party payors, commercial insurance carriers, and health maintenance organizations. The basis for payment under these agreements includes prospectively determined per diem and per visit rates and fees, discounts from established charges, fee schedules, and reasonable cost subject to limitations. Medicare outpatient services are paid under a prospective payment system whereby services are reimbursed on a predetermined amount for each outpatient procedure, subject to various mandated modifications.

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 varies by payor and applies to a broader array of health care services. Also, certain payors are required to fund a pool for graduate medical education expenses through surcharges on payments to hospitals for inpatient services or through voluntary election to pay a covered lives assessment directly to the New York State Department of Health.

(b) Skilled Nursing and Home Health Care Services

Net patient service revenue for skilled nursing services under the Medicaid program is based on a modified pricing system using the Resource Utilization Group (RUGs) patient classification system. Under this methodology, reimbursement is at a predetermined rate depending on the intensity of the services rendered to residents regardless of the cost of delivering those services. Medicaid's predetermined rate is computed using cost report data from the facility's designated base year and elements from annual cost report filings. Medicare reimbursement for skilled nursing services are determined on a PPS basis. Under skilled nursing PPS, a single per diem rate is paid that covers all routine, ancillary, and capital related costs. The per diem payment is adjusted for each Medicare beneficiary, based on their care needs as measured by a patient assessment form.

Home health care services for Medicare are reimbursed under a prospective payment system (PPS) which is based on a 60 day episode, case mix adjusted into one of the home health resource groups (HHRG). Adjustments exist for low and high utilization of services during a 60-day episode. Medicare will generally make an initial payment of 60% based on the submitted HHRG with the balance of the payment due at the end of the 60 day episode or at discharge, whichever occurs sooner. For all Non-Medicare payors, the basis of payment includes prospectively determined per visit rates and fees, discount on charges, and fee schedules.

Kaleida is required to prepare and file various reports of actual and allowable costs annually. Provisions have been made in the consolidated financial statements for prior and current years' estimated final settlements. The difference between the amount provided and the actual final settlement is recorded as an adjustment to net patient service revenue as adjustments become known or as years are no longer subject to audits, reviews, and investigations. During 2010 and 2009, Kaleida recorded adjustments for estimated settlements with third-party payors, which resulted in changes to net patient service revenue of approximately \$1.7 million and \$(5.7) million, respectively. Net patient service revenue from Medicare and New York State Medicaid programs accounted for approximately 22% and 10%, respectively, of total net patient service revenue for the year ended December 31, 2010, and 23% and 11%, respectively, of total net patient service revenue for the year ended December 31, 2009. Significant concentrations of patient accounts receivable at December 31, 2010 and 2009 include Medicare 21% and 21%, Medicaid 13% and 12%, and health maintenance organizations 45% and 42%, respectively.

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Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Kaleida receives regulatory inquiries and reviews in the normal course of business. 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. Kaleida believes it is in substantive compliance with all applicable laws and regulations.

(5) Self-Insurance Trusts and Estimated Self-Insurance Reserves

Kaleida is partially self-insured for medical malpractice, general liability, and workers' compensation costs, and excess liability policies are generally maintained for exposures in excess of self-insurance retentions. Trusts are established for the purpose of setting aside assets based on actuarial funding recommendations. Under the trust agreements, the trust assets can be used only for payment of losses, related expenses, and the costs of administering the trust. The estimated liability for both asserted and unasserted self-insurance claims for medical malpractice, general liability and workers' compensation are discounted at 3.5% at December 31, 2010 and 2009. Estimated self-insurance reserves are approximately $161 million and $154 million at December 31, 2010 and 2009, respectively. As of December 31, 2010 and 2009, $7.8 million and $7.7 million, respectively, is recoverable from Kaleida's excess liability policies. At December 31, 2010, Kaleida has irrevocable secured letters of credit supporting the medical malpractice and workers compensation self-insurance programs totaling approximately $42.2 million. The annual fee for the letters of credit approximates 75 basis points and they renew automatically unless the issuer notifies both parties in writing sixty days in advance.

At December 31, 2010 and 2009, there were various actions filed against Kaleida by former patients and others seeking compensatory and punitive damages. In 2009, Kaleida secured a surety bond in order to preserve its right to appeal certain judgments filed for ongoing claims. The surety bond is collateralized with an irrevocable letter of credit. The letter of credit is secured with assets within the self insurance trust.

Management believes current estimates for known and unknown claims reflected in the self-insurance accrual are adequate. If the ultimate costs differ from the estimates, such additional amounts will be accrued when known. Excess coverage retroactive to the date of Kaleida's formation has been obtained for incidents reported after December 31, 2000.

(6) Investments and Assets Limited as to Use

The components of investments and assets limited as to use at December 31 are summarized as follows:

	2010	2009
	(Dollars in thousands)	
Current investments:		
Cash and cash equivalents	$ 823	12,148
Equity and fixed income mutual funds	49,305	38,330
Marketable equity securities	67,157	76,064
Limited partnerships	31,510	23,261
	148,795	149,803
Assets limited as to use:		
Designated under debt and lease agreements:		
Cash and cash equivalents	23,411	20,956
U.S. government obligations	27,420	29,729
	50,831	50,685
Designated under self-insurance programs:		
Cash and cash equivalents	39,511	43,081
U.S. government obligations	3,492	3,488
Equity and fixed income mutual funds	33,043	24,707
Marketable equity securities	45,111	43,086
Limited partnerships	17,435	14,396
	138,592	128,758
Board designated and donor restricted:		
Cash and cash equivalents	8,411	11,414
U.S. government obligations	259	259
Equity and fixed income mutual funds	25,685	19,744
Marketable equity securities	34,953	38,325
Limited partnerships	16,433	11,747
	85,741	81,489
Other:		
Cash and cash equivalents	1,380	1,589
	276,544	262,521
Total investments	$ 425,339	412,324

(Continued)

The components of investment return includes the following for the years ended December 31:

		2010	2009
		(Dollars in thousands)	
Other operating revenue:			
Interest and dividends	$	3,256	3,330
Other income:			
Investment income:			
Interest and dividends	$	2,855	3,305
Change in interests in limited partnerships		9,484	5,395
	$	12,339	8,700
Net realized losses on sale of investments	$	(189)	(6,870)
Net change in unrealized gains and losses on investments	$	14,917	41,312

(7) Fair Value Measurements

The following is a description of the valuation methodologies used by Kaleida for its assets measured at fair value on a recurring basis:

Cash equivalents: Cash equivalents are valued at the NAV reported by the financial institution.

Equity and fixed income securities: Kaleida's equity and fixed income portfolios consist of direct investment in individual equity and fixed income securities and U.S. government obligations that are valued based on quoted market prices (Level 1 measurements). If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or, if necessary, matrix pricing from a third party pricing vendor to determine fair value (Level 2 measurements). Matrix prices are based on quoted prices for fixed income securities with similar coupons, ratings and maturities, rather than on specific bids and offers for a designated security.

In addition, Kaleida's equity and fixed income portfolios include investments in actively traded mutual funds valued at the closing price on the active market in which the individual funds are traded (Level 1 measurements) and pooled/commingled investment funds where Kaleida owns shares, units, or interests of pooled funds rather than the underlying securities in the fund. The pooled/commingled funds are measured at fair value based on the nature of the underlying investments, timing of the pricing of the funds NAV and liquidity restrictions for the funds (Level 1 and 2 measurements).

Limited partnerships: Limited partnerships consist of private, domestic and global equities, real assets, and hedge funds. Limited partnership investments are typically redeemable with the fund at NAV under the original terms of the partnership agreement and/or subscription agreements. The estimation of fair value of investments in limited partnerships for which the underlying securities do not have a readily determinable value is made using the NAV per share or its equivalent as a practical expedient. Kaleida owns interests in these funds rather than in securities or assets underlying each fund and, therefore, is generally required to consider such investments as Level 2 or Level 3, even though certain underlying securities may not be difficult to value or may be readily marketable.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although Kaleida 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 fair value measurement at the reporting date. Also, because the use of NAV as a practical expedient to estimate fair value of certain investments, the level in the fair value hierarchy in which each fund's fair value measurement is classified is based primarily on Kaleida's ability to redeem its interest in the fund at or near the date of the consolidated balance sheet. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes are not necessarily an indication of the risk associated with investing in those investments or a reflection on the liquidity of each fund's underlying assets and liabilities.

The following tables present Kaleida's financial assets at December 31, 2010 and 2009 that are measured at fair value on a recurring basis. The financial assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurements (dollars in thousands):

	2010					
	Total	Level 1	Level 2	Level 3	Redemption frequency	Days Notice
Investments:						
Cash and cash equivalents	$ 73,536	73,536	—	—	Daily	Same day
U.S. government obligations	31,171	—	31,171	—	Daily	Same day
Marketable equity securities:						
Large-cap securities	54,554	42,257	12,297	—	Daily-monthly	Same day – 60 days
International securities	92,667	—	92,667	—	Daily-monthly	2 days – 30 days
Equity and fixed income mutual funds	108,033	98,018	10,015	—	Monthly	60 days
Limited partnerships:						
Hedge funds	22,738	—	—	22,738	Quarterly-bi-annually	60-65 days
Private equity	2,114	—	—	2,114	See (a) below	See (a) below
Global equity	24,727	—	24,727	—	Daily-monthly	3 days – 30 days
Domestic equity	12,310	—	—	12,310	Annually	60 days
Real assets	3,489	—	—	3,489	See (a) below	See (a) below
	$ 425,339	213,811	170,877	40,651		

	2009					
	Total	**Level 1**	**Level 2**	**Level 3**	**Redemption frequency**	**Days Notice**
Investments:						
Cash and cash equivalents	$ 89,188	89,188	—	—	Daily	Same day
U.S. government obligations	33,476	—	33,476	—	Daily	Same day
Marketable equity securities:						
Large-cap securities	91,104	70,461	20,643	—	Daily-monthly	Same day – 60 days
International securities	66,371	—	66,371	—	Semi-monthly – monthly	2 days – 30 days
Equity and fixed income mutual funds	82,781	72,513	10,268	—	Monthly	60 days
Limited partnerships:						
Hedge funds	21,682	—	—	21,682	Quarterly-bi-annually	60-65 days
Private equity	12,447	—	—	12,447	See (a) below	See (a) below
Domestic equity	10,692	—	—	10,692	Annually	60 days
Real assets	4,583	—	—	4,583	See (a) below	See (a) below
	$ 412,324	232,162	130,758	49,404		

(a) Certain limited partnership investments include noncontrolling shares or interests in funds where the controlling general partner serves as the investment manager. Such limited partnership shares are typically not eligible for redemption from the fund or general partner, but are typically sold to third party buyers in private transactions that typically can be completed in approximately 90 days. It is the intent of Kaleida to hold these investments until the fund has fully distributed all proceeds to the limited partners and the term of the partnership agreements expire.

Under the terms of certain agreements, Kaleida has committed to contribute a specified level of capital over a defined period of time. Through December 31, 2010, Kaleida has committed to contribute approximately $61.3 million to such limited partnerships, of which Kaleida has contributed approximately $36.6 million and has outstanding commitments of $24.7 million.

There were no significant transfers into or out of Level 1 and Level 2 fair value measurements during the year ended December 31, 2010.

The following tables present additional information about the changes in Level 3 assets measured at fair value for the years ended December 31 (dollars in thousands):

	2010				
	Total	**Real assets**	**Hedge funds**	**Private equity**	**Domestic equity**
Balance, beginning of year	$ 49,404	4,583	21,682	12,447	10,692
Purchases, sales, issuances, and settlements, net	(11,323)	(1)	(112)	(11,210)	—
Realized gains (losses)	1,178	1	(30)	1,207	—
Change in unrealized gains and losses	1,392	(1,094)	1,198	(330)	1,618
Balance, end of year	$ 40,651	3,489	22,738	2,114	12,310

	2009				
	Total	**Real assets**	**Hedge funds**	**Private equity**	**Domestic equity**
Balance, beginning of year	$ 52,134	5,819	37,049	2,122	7,144
Purchases, sales, issuances, and settlements, net	(8,207)	(46)	(18,206)	10,045	—
Realized gains (losses)	(754)	35	(805)	16	—
Change in unrealized gains and losses	6,231	(1,225)	3,644	264	3,548
Balance, end of year	$ 49,404	4,583	21,682	12,447	10,692

Liquidity

The following presents the fair value of Kaleida's investments as of December 31 by redemption period:

	2010	**2009**
Investments redemption period:		
Daily	$ 172,148	193,125
Semi – monthly	13,845	15,045
Monthly	198,694	154,750
Quarterly	11,364	10,924
Bi – annual	11,375	10,758
Annual	12,310	10,692
Illiquid	5,603	17,030
Total	$ 425,339	412,324

The limitation and restrictions on Kaleida's ability to redeem or sell these investments vary by investment and range from required notice periods for certain limited partnership and hedge funds, to specified terms at inception. Based upon the terms and conditions in effect at December 31, 2010, redemption periods expire in 2013.

(8) Property and Equipment

A summary of property and equipment at December 31 follows:

		2010	2009
		(Dollars in thousands)	
Land and land improvements	$	25,140	22,860
Buildings, fixtures, and improvements		653,819	650,591
Movable equipment		545,724	525,991
		1,224,683	1,199,442
Less accumulated depreciation and amortization		985,850	959,330
		238,833	240,112
Construction in progress		112,355	42,267
	$	351,188	282,379

During 2009, Kaleida began construction of the global heart vascular institute (GHVI) adjacent to Buffalo General Hospital and in 2010 began construction of a new skilled nursing facility (SNF). The GHVI will be a ten story building with an estimated cost of approximately $291 million. The project is a collaboration between the State University of New York at Buffalo (UB) and Kaleida. It is expected that UB will occupy the top four floors of the GHVI and UB will contribute approximately $118 million to cover construction and fit-up costs associated with that space. Kaleida will fund its share of the GHVI with $65 million in HEAL NY grant funding (note 2(j)) and the proceeds from government insured debt of $100 million and a $8 million equity contribution (note 9). The SNF will be a four story building housing 300 long term care beds with an estimated cost of approximately $65 million. Kaleida is funding this project with $9.7 million in HEAL NY grant funding and the proceeds from government insured debt of $51.9 million and a $3.3 million equity contribution (note 9). Commitments outstanding at December 31, 2010, for the construction of the GHVI and SNF totaled $151.2 million.

Further, Kaleida concluded that the developments in 2009 related to DOH's approval and the subsequent financing and initiation of construction of the GHVI, was the triggering event for relocating services and the closure of Gates by April 2012. Accordingly, Kaleida recorded a charge of approximately $20.4 million to write down the net book value of Gates and various other projects impacted by the Berger Commission recommendations.

Net property and equipment includes approximately $18.1 million and $26.4 million applicable to capital leases at Decembers 31, 2010 and 2009, respectively.

During 2010 Kaleida capitalized interest expense of approximately $719,000. No interest expense was capitalized in 2009.

(9) Long-Term Debt

Long-term debt consists of the following at December 31:

		2010	2009
		(Dollars in thousands)	
Mortgage payable in monthly installments of $625,000, including interest at 5.25% through August 1, 2023. (a)	$	69,301	73,057
Mortgage payable in monthly installments of $314,000 including interest at 3.29% through April 1, 2020. (a)		45,056	49,218
Mortgage notes payable in monthly installments of $338,000, including interest at 5.05%, through October 1, 2033. (a)		54,831	56,078
Mortgage notes payable in monthly installments of $107,000, including interest at 5.05%, through February 1, 2032. (a)		16,746	17,178
Mortgage payable in monthly installments of $48,000 including interest at 6.25% through July 1, 2024. (a)		5,246	5,485
Mortgage notes payable with interest only payments at 6.35% through February 2012. Once fully drawn, monthly principal and interest will be required through February 1, 2037. (a)		23,330	5,885
Mortgage notes payable with interest only payments at 5.73% through February 2012. Once fully drawn, monthly principal and interest will be required through February 1, 2037. (a)		10,465	—
Capital lease obligations, less imputed interest of $632,000 and $1,126,000 at December 31, 2010 and 2009, respectively. (b)		10,492	16,177
Industrial development bond payable in monthly fixed principal installments of $25,000, plus interest at 5.57% through January 2011. Thereafter, varying monthly principal and interest installments through January 2026. The bonds are secured by the related assets being financed.		2,241	2,541
Other		7,725	9,212
		245,433	234,831
Less current maturities		18,889	18,678
	$	226,544	216,153

(Continued)

(a) Mortgages Payable

The mortgages payable, which are insured by the U.S. Department of Housing and Urban Development (HUD), are secured by essentially all assets of the respective borrowing entities.

On December 4, 2009, Kaleida secured a loan commitment of approximately $100.3 million by entering into a new mortgage note and building loan agreement. The proceeds from the loan commitment will be used to finance the cost of the development of the GHVI in order to carry out the closure of services and relocation from Gates (see note 1). The mortgage note, when fully drawn, will have a 25 year term, fixed monthly payments and an annual interest rate of 6.35%. The mortgage note is insured by HUD. At December 31, 2010, Kaleida has drawn $23.3 million for costs related to the GHVI project.

On September 1, 2010, Kaleida refinanced the existing mortgage of $46.2 million maturing in April 2020 related to improvements made to both the Millard Fillmore Gates Hospital and the Millard Fillmore Suburban Hospital. Although the principal amount refinanced remained the same, the mortgage term, interest rate and monthly payment were modified. The previous monthly installments were $574,000 including interest at 6.04%. The new mortgage remains insured by HUD.

On December 7, 2010, Kaleida secured a loan commitment of approximately $51.9 million by entering into a new mortgage note and building loan agreement. The proceeds from the loan commitment will be used to finance the cost of the construction of a new skilled nursing facility (SNF). The facility will replace the Gates and Deaconess skilled nursing facilities (see note 1). The mortgage note, when fully drawn, will have a 25 year term, fixed monthly payments and an annual interest rate of 5.73%. The mortgage note is insured by HUD. At December 31, 2010, Kaleida has drawn $10.5 million for costs related to the skilled nursing project.

Kaleida has entered into Regulatory Agreements with HUD, which set forth certain provisions and requirements. Among these requirements are certain performance indicators, financial ratios, and reporting requirements. Also among these requirements is the funding of a Mortgage Reserve Fund (Mortgage Reserve) as established by the Mortgage Reserve Fund Agreement, dated May 20, 2004, as amended September 21, 2006, December 4, 2009, and December 7, 2010. As required under the Mortgage Reserve, Kaleida is required to maintain a certain balance either through deposits or investment earnings. Failure to comply with these requirements may result in oversight activities by HUD.

(Continued)

Under the terms of the borrowing agreements, Kaleida established certain bank trustee accounts which include the Mortgage Reserve Fund and Kaleida's equity contribution for the GHVI project. Included in the accompanying consolidated financial statements, classified as assets limited as to use, are Kaleida's balances in these funds at December 31 as follows:

	2010	2009
	(Dollars in thousands)	
Mortgage reserve fund	$ 39,489	42,683
GHVI project equity	8,018	8,002
SNF project equity	3,324	—
	$ 50,831	50,685

Construction costs payable at year end will be paid with proceeds advanced from the HUD insured loan commitments secured by Kaleida in 2010 and 2009.

(b) ***Capital Leases***

The majority of the capital lease obligations represent arrangements entered into with a bank to finance acquisitions of various pieces of equipment. These arrangements are administered by the Dormitory Authority of the State of New York (DASNY) as part of their Tax-Exempt Leasing Program (TELP).

Future annual principal payments of long-term debt for the next five years as of December 31, 2010 follows (dollars in thousands):

2011	$ 18,889
2012	18,140
2013	18,469
2014	16,551
2015	16,765

(c) ***Line of Credit***

In October 2009, Kaleida entered into a Revolving Credit Loan Agreement (Loan Agreement) with a financial institution. The Loan Agreement, which expires in September 2011, requires Kaleida to payoff the outstanding balance annually for a period of twenty business days. The maximum aggregate principal amount of credit that can be extended under the Loan Agreement is $20 million. Interest is payable monthly and is calculated at the greater of the adjusted LIBOR rate plus a margin of 2.65% or a base rate calculated as the bank's prime rate plus 200 basis points. Kaleida also pays monthly an unused facility fee equal to 20 basis points per year on the average unused daily balance. DASNY and HUD agreed to subordinate their security interest in the first $30 million worth of patient accounts receivable to the bank as collateral for borrowings on the Loan Agreement. At December 31, 2010 and 2009, $10 million and $6 million, respectively, was outstanding on the Loan Agreement which continues to bear interest at 3.5%.

In March 2010, Kaleida Health entered into an Equipment Line of Credit Agreement with a private financing company. The maximum aggregate principal amount of credit that can be extended under the equipment line of credit is $10 million. Interest is payable monthly and is calculated at the five year tax exempt lease rate minus one quarter of one percent. At December 31, 2010 there are no borrowings on the Line of Credit Agreement.

(10) Lease Commitments

Kaleida leases various equipment and facilities under noncancelable operating leases expiring at various dates in the future. Rental expense for all operating leases were approximately $27.5 million and $26 million in 2010 and 2009, respectively. Future minimum payments under noncancelable operating leases as of December 31, 2010 having lease terms in excess of one year are as follows (dollars in thousands):

2011	$	19,220
2012		16,351
2013		14,743
2014		14,507
2015		14,466

(11) Pension and Other Postretirement Benefits

(a) Pension Plans

Defined Benefit Plan – Kaleida sponsors a defined benefit plan (the Plan) covering substantially all of its eligible employees. The Plan provides benefits based upon years of service and the employee's compensation. Kaleida's funding policy is to contribute amounts required by the Employee Retirement Income Security Act (ERISA). The amount to be funded is subject to annual review by management and Kaleida's consulting actuary.

The following table sets forth the defined benefit pension plan's projected benefit obligation and fair value of plan assets at December 31:

		2010	2009
		(Dollars in thousands)	
Change in projected benefit obligation:			
Benefit obligation at beginning of year	$	478,339	434,838
Service cost		18,229	16,637
Interest cost		28,083	26,357
Plan amendments		—	194
Actuarial losses		46,502	13,850
Benefits paid		(13,340)	(13,537)
Benefit obligation at end of year	$	557,813	478,339
Change in plan assets:			
Fair value of plan assets at beginning of year	$	326,036	255,848
Actual return on plan assets		42,204	63,025
Employer contributions		32,700	20,700
Benefits paid		(13,340)	(13,537)
Fair value of assets at end of year	$	387,600	326,036

The funded status of the plan and amounts recognized in the consolidated balance sheets at December 31, are as follows:

		2010	2009
		(Dollars in thousands)	
Funded status at end of year:			
Fair value of plan assets	$	387,600	326,036
Projected benefit obligation		557,813	478,339
Pension liability recognized in the consolidated balance sheets at end of year (included as a component of other long-term liabilities)	$	(170,213)	(152,303)
Amount recorded in unrestricted net assets at end of year:			
Net actuarial loss	$	(169,382)	(136,988)
Prior service costs		(1,238)	(1,047)
	$	(170,620)	(138,035)

The estimated prior service credit and net actuarial loss that will be amortized from unrestricted net assets in 2011 are approximately $(80,000) and $8.4 million, respectively.

The accumulated benefit obligations at the Plan's measurement date for 2010 and 2009 was approximately $480 million and $417 million, respectively.

The components of net periodic pension cost for the years ended December 31 is as follows:

		2010	2009
		(Dollars in thousands)	
Service cost	$	18,229	16,637
Interest cost		28,083	26,357
Expected return on plan assets		(31,888)	(29,870)
Amortization of net prior service credit		(191)	(209)
Amortization of actuarial loss		3,792	1,842
Net periodic pension cost	$	18,025	14,757

The weighted average assumptions used to determine pension cost and benefit obligations at the Plan's measurement date (December 31):

	2010	2009
Discount rate for benefit obligations	5.49%	6.00%
Discount rate for net pension cost	6.00	6.20
Rate of compensation increase	4.00	4.00
Expected long-term rate of return on plan assets	8.50	8.50

The investment policy specifies the type of investment vehicles appropriate for the plan, asset allocation guidelines, criteria for selection of investment managers, procedures to maintain overall investment performance, as well as investment manager performance. The expected long-term rate of return on plan assets reflects long-term earnings expectations on existing plan assets and those contributions expected to be received during the current plan year. In estimating that rate, appropriate consideration was given to historical returns earned by plan assets in the fund and the rates of returns expected to be available for reinvestment. Rates of return were adjusted to reflect current capital market assumptions and investment allocations.

The range of target investment allocation percentages at December 31, 2010 are listed below:

Cash	0-5%
Equity securities:	
Domestic	6-10%
International	6-8%
Fixed income securities:	
Domestic	13-17%
Emerging market	2-4%
Other:	
Global asset	13-15%
Risk parity	13-17%
Hedge funds	0-17%
Private equity	0-15%
Real assets	4-11%

The following tables present Kaleida's defined benefit pension plan's assets at December 31, 2010 and 2009 that are measured at fair value on a recurring basis. The hierarchy and inputs to valuation techniques to measure fair value of the plan's assets are the same as outlined above in note 7 of the consolidated financial statements (dollars in thousands):

	2010					
	Total	Level 1	Level 2	Level 3	Redemption frequency	Days Notice
Investments:						
Cash and cash equivalents	$ 17,621	17,621	—	—	Daily	Same day
Insurance contract	3,931	—	3,931	—	Daily	Same day
Marketable equity securities:						
Large-cap securities	62,368	46,939	15,429	—	Daily	Same day – 60 day
International securities	107,243	—	107,243	—	Daily-monthly	2 days – 30 days
Equity and fixed income mutual funds	87,036	77,089	9,947	—	Monthly	60 days
Limited partnerships:						
Hedge funds	32,179	—	—	32,179	Quarterly-bi-annually	60-65 days
Private equity	19,518	—	—	19,518	See note 7(a)	See note 7(a)
Global equity	28,058	—	28,058	—	Daily-monthly	3 days – 30 days
Domestic equity	19,733	—	—	19,733	Annually	60 days
Real assets	9,913	—	—	9,913	See note 7(a)	See note 7(a)
	$ 387,600	141,649	164,608	81,343		

	2009					
	Total	Level 1	Level 2	Level 3	Redemption frequency	Days Notice
Investments:						
Cash and cash equivalents	$ 25,920	25,920	—	—	Daily	Same day
Insurance contract	4,331	—	4,331	—	Daily	Same day
Marketable equity securities:						
Large-cap securities	57,455	38,160	19,295	—	Daily	Same day – 60 days
International securities	71,413	—	71,413	—	Semi-monthly – monthly	2 days– 30 days
Equity and fixed income mutual funds	85,350	75,626	9,724	—	Monthly	60 days
Limited partnerships:						
Hedge funds	30,596	—	—	30,596	Quarterly-bi-annually	60-65 days
Private equity	26,499	—	—	26,499	See note 7(a)	See note 7(a)
Domestic equity	16,391	—	—	16,391	Annually	60 days
Real assets	8,081	—	—	8,081	See note 7(a)	See note 7(a)
	$ 326,036	139,706	104,763	81,567		

The insurance contract held within Kaleida's defined benefit plan is recorded at contract value which approximates fair value.

The following tables present additional information about the changes in Level 3 assets measured at fair value for the years ended December 31 follows (dollars in thousands):

	2010				
	Total	Real assets	Hedge funds	Private equity	Domestic equity
Balance, beginning of year	$ 81,567	8,081	30,596	26,499	16,391
Purchases, sales, issuances, and settlements, net	(8,079)	3,830	(148)	(11,761)	—
Realized gains (losses)	2,082	5	(40)	2,117	—
Change in unrealized gains and losses	5,773	(2,003)	1,771	2,663	3,342
Balance, end of year	$ 81,343	9,913	32,179	19,518	19,733

	2009				
	Total	Real assets	Hedge funds	Private equity	Domestic equity
Balance, beginning of year	$ 63,402	8,231	38,933	8,472	7,766
Purchases, sales, issuances, and settlements, net	9,626	2,158	(11,876)	15,844	3,500
Realized gains (losses)	(2,794)	50	(2,936)	92	—
Change in unrealized gains and losses	11,333	(2,358)	6,475	2,091	5,125
Balance, end of year	$ 81,567	8,081	30,596	26,499	16,391

Contributions – For the plan year ended December 31, 2010, Kaleida has contributed $32.7 million. Expected contributions for the plan year ending December 31, 2011 will be made at a level recommended by Kaleida's consulting actuary and in accordance with ERISA funding requirements.

Estimated Future Benefit Payments – The following benefit payments, which reflect expected future service, are as follows for the Plan (dollars in thousands):

2011	$	21,430
2012		23,144
2013		24,778
2014		26,655
2015		28,454
2016 – 2019		184,408

The expected benefits are based on the same assumptions used to measure Kaleida's benefit obligations at December 31, 2010 and include future employee service.

Other Pension Benefit Plans – In addition, Kaleida contributes to a multi-employer defined benefit pension plan as required by union contracts from which benefits are paid to certain union employees. Additionally, Kaleida provides an employer-matched Tax Sheltered Annuity program (403(b) Plan) for nonunion employees. Total expense under these plans was approximately $2.5 million and $2.6 million for 2010 and 2009, respectively.

(b) Retiree Health and Life Insurance Plan

Kaleida also maintains a contributory retiree health and life insurance plan covering only certain eligible employees of DeGraff Memorial Hospital (DeGraff). The following table sets forth the funded status and amounts recognized in the consolidated balance sheets at December 31:

		2010	2009
		(Dollars in thousands)	
Accumulated postretirement obligation at end of year	$	5,852	5,446
Fair value of plan assets at end of year		—	—
Postretirement obligation recognized at end of year included as a component of other long-term liabilities	$	(5,852)	(5,446)

(Continued)

Net postretirement benefit cost was approximately $451,000 and $368,000 for the years ended December 31, 2010 and 2009, respectively. The weighted average assumptions used to determine postretirement benefit cost and obligations at the Plan's measurement date (December 31):

	2010	2009
Discount rate for benefit obligations	5.20%	5.80%
Discount rate for net postretirement cost	5.80	6.30

For measurement purposes, 2010 increases in the per capita cost of covered health care benefits were assumed for medical and prescription drugs at 8.25%. The rate is assumed to decrease gradually to 5% by 2018 and remain at that level thereafter for all classifications. A one-percentage point change in assumed healthcare cost trend rates would not have a material impact on the future cost or benefit obligation.

(12) Asset Retirement Obligations

Kaleida has asset retirement obligations (AROs) arising from regulatory requirements to perform certain asset retirement activities in the event they renovate or demolish buildings in the future. The liability was initially measured at fair value and subsequently is adjusted for accretion expense and changes in the amount or timing of the estimated cash flows. The following table presents the activity for the AROs for the years ended December 31:

		2010	2009
		(Dollars in thousands)	
Balance at beginning of year	$	10,217	10,049
Net obligations settled in current period		(245)	(605)
Accretion expense		713	773
Balance at end of year	$	10,685	10,217

(13) Temporarily and Permanently Restricted Net Assets

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

		2010	2009
		(Dollars in thousands)	
Capital expansion and improvements	$	53,678	66,507
Advancement of medical education and research and healthcare services		59,295	48,701
	$	112,973	115,208

(Continued)

Permanently restricted net assets at December 31 are restricted as follows:

		2010	2009
		(Dollars in thousands)	
Funds to be held in perpetuity, the income from which is expendable to support healthcare services, including medical research	$	10,824	13,040
Funds to be held in perpetuity, the income from which is expendable to support pediatric healthcare services		4,576	6,509
	$	15,400	19,549

In 2010 and 2009, net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes of operating expenses of $7.7 million and $9.4 million, respectively, and purchases of equipment of $24.6 million and $11.5 million, respectively.

(14) Functional Expenses

Kaleida provides general healthcare services to residents within its geographic location. Expenses related to these services are as follows for the years ended December 31:

		2010	2009
		(Dollars in thousands)	
Healthcare services	$	1,013,584	997,079
General and administrative		173,421	162,315
	$	1,187,005	1,159,394

(15) Commitments and Contingencies

(a) Concentration of Credit Risk

Financial instruments that potentially subject Kaleida to concentrations of credit risk consist primarily of accounts receivable and certain investments. Investments, which include government obligations, marketable equity securities, other alternative investments funds, and fixed income securities, are not concentrated in any corporation or industry.

Kaleida receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payors, including Medicare, Medicaid, and various health maintenance organizations. Kaleida has not historically incurred any significant concentrated credit losses in the normal course of business.

(Continued)

(b) ***Conversion of DeGraff Memorial Hospital***

The Berger Commission had recommended that DeGraff Memorial Hospital be converted to a residential health care facility. Based upon subsequent consideration, the NYS Commissioner of Health (Commissioner) deferred that recommendation until a further market and need based analysis could be completed. During early 2011, the Commissioner has granted a permanent waiver to Kaleida related to this recommendation as it converts to a geriatric hospital center of excellence.

(c) ***Disposition of Waterfront Health Care Center***

In November 2009, Kaleida filed a request with DOH to close Waterfront Health Care Center. On January 15, 2010, DOH approved the plan of closure. During 2010, Kaleida worked through a process to sell the facility and the operation. In February 2011, Kaleida entered into a letter of intent to transition the operation to another operator. It is anticipated that the transition will occur in May 2011, with the transaction closing a short time after.

(d) ***Collective Bargaining Agreements***

A significant portion of Kaleida employees work under collective bargaining agreements, the majority of which will expire in May 2011.