



AUDITED FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

The William W. Backus Hospital  
Years Ended September 30, 2012 and 2011  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

# The William W. Backus Hospital

## Audited Financial Statements and Supplementary Information

Years Ended September 30, 2012 and 2011

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## Report of Independent Auditors

The Board of Trustees  
The William W. Backus Hospital

We have audited the accompanying balance sheets of The William W. Backus Hospital (the Hospital) as of September 30, 2012 and 2011, and the related statements of operations and changes in net assets and cash flows for the years then ended. 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 in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Hospital's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital'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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The William W. Backus Hospital as of September 30, 2012 and 2011, and the results of its operations and changes in net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the accompanying financial statements, in 2012 the Hospital changed its method of reporting estimated insurance claims receivable and estimated insurance claims liabilities with the adoption of the Accounting Standards Update No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*.



December 14, 2012

# The William W. Backus Hospital

## Balance Sheets

	<b>September 30</b>	
	<b>2012</b>	<b>2011</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	<b>\$ 107,428,365</b>	\$ 93,136,217
Assets whose use is limited – required for current liabilities	<b>7,433,046</b>	5,885,482
Accounts receivable, less allowance for uncollectible accounts (2012 – \$17,725,000; 2011 – \$21,200,000, approximately)	<b>32,015,340</b>	32,373,122
Pledges receivable	<b>31,723</b>	101,211
Due from affiliates	<b>562,041</b>	164,147
Inventories of supplies	<b>3,548,865</b>	3,704,067
Prepaid expenses and other	<b>3,330,298</b>	1,624,606
Total current assets	<b>154,349,678</b>	136,988,852
Assets whose use is limited:		
Board-designated investments	<b>116,868,765</b>	105,438,402
Held by trustee	<b>30,175,064</b>	28,078,427
Total assets whose use is limited	<b>147,043,829</b>	133,516,829
Less assets whose use is limited – required for current liabilities	<b>7,433,046</b>	5,885,482
	<b>139,610,783</b>	127,631,347
Property, plant, and equipment, net	<b>91,354,486</b>	89,983,664
Deferred financing costs	<b>1,754,758</b>	1,842,330
Other assets	<b>5,881,388</b>	1,542,292
Total assets	<b>\$ 392,951,093</b>	\$ 357,988,485

The William W. Backus Hospital

Balance Sheets (continued)

	<b>September 30</b>	
	<b>2012</b>	<b>2011</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable – trade	\$ 9,176,344	\$ 9,918,459
Salaries and wages, payroll taxes, and taxes withheld from payroll	6,802,151	6,666,138
Other accrued liabilities	6,890,306	4,999,447
Employee related obligations	3,834,900	3,942,900
Due to third-party reimbursement agencies	1,193,235	4,683,178
Interest payable	714,869	734,838
Current portion of long-term debt	2,346,210	2,115,360
Total current liabilities	<u>30,958,015</u>	<u>33,060,320</u>
Other liabilities:		
Long-term debt and capital lease obligations	65,056,990	62,389,713
Employee related obligations	71,736,171	69,884,879
Self-insured professional liability	9,685,357	10,853,762
Due to third-party reimbursement agencies	17,000,185	19,162,526
Other	652,262	443,183
	<u>164,130,965</u>	<u>162,734,063</u>
Net assets:		
Unrestricted	187,215,454	153,345,431
Temporarily restricted	2,890,743	1,399,547
Permanently restricted	7,755,916	7,449,124
Total net assets	<u>197,862,113</u>	<u>162,194,102</u>
Total liabilities and net assets	<u>\$ 392,951,093</u>	<u>\$ 357,988,485</u>

*See accompanying notes.*

# The William W. Backus Hospital

## Statements of Operations

	<b>Year Ended September 30</b>	
	<b>2012</b>	<b>2011</b>
Operating revenues:		
Net patient service revenue	<b>\$ 283,219,755</b>	\$ 271,933,218
Provision for uncollectible accounts	<b>(7,949,694)</b>	(12,492,090)
Net patient service revenue less provision for uncollectible accounts	<b>275,270,061</b>	259,441,128
Other operating revenues	<b>7,774,319</b>	4,848,198
Net assets released from restriction	<b>174,552</b>	673,194
	<b>283,218,932</b>	264,962,520
Operating expenses:		
Salaries, wages, and professional fees	<b>114,140,337</b>	110,169,857
Payroll taxes and other fringe benefits	<b>32,008,290</b>	25,655,346
Supplies, insurance, and other	<b>89,223,225</b>	83,949,646
Depreciation and amortization	<b>18,006,195</b>	16,971,187
Interest	<b>3,276,169</b>	3,247,715
	<b>256,654,216</b>	239,993,751
Operating income	<b>26,564,716</b>	24,968,769
Nonoperating gains and (losses):		
Income from investments	<b>12,701,591</b>	581,947
Contributions	<b>147,058</b>	158,300
Other	<b>(29,536)</b>	(565,873)
Excess of revenues over expenses	<b>\$ 39,383,829</b>	\$ 25,143,143

*See accompanying notes.*

The William W. Backus Hospital  
Statements of Changes in Net Assets

	<b>Total</b>	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>
Net assets, September 30, 2010	\$ 158,943,087	\$ 147,366,124	\$ 4,101,543	\$ 7,475,420
Excess of revenues over expenses	25,143,143	25,143,143		
Investment (loss) income	(275,296)		(346,369)	71,073
Change in pension funding and postretirement obligation	(21,176,691)	(21,176,691)		
Transfer to affiliates	(245,005)	(245,005)		
Contributions	580,427		575,427	5,000
Change in net assets held in trust	(102,369)			(102,369)
Net assets released from restriction used for purchase of equipment	2,257,860	2,257,860		
Net assets released from restriction	(2,931,054)		(2,931,054)	
Increase (decrease) in net assets	<u>3,251,015</u>	<u>5,979,307</u>	<u>(2,701,996)</u>	<u>(26,296)</u>
Net assets, September 30, 2011	162,194,102	153,345,431	1,399,547	7,449,124
Excess of revenues over expenses	<b>39,383,829</b>	<b>39,383,829</b>		
Investment income	<b>1,315,791</b>		<b>1,315,791</b>	
Change in pension funding and postretirement obligation	<b>(4,361,697)</b>	<b>(4,361,697)</b>		
Transfer to affiliates	<b>(1,248,123)</b>	<b>(1,248,123)</b>		
Contributions	<b>445,971</b>		<b>445,971</b>	
Change in net assets held in trust	<b>306,792</b>			<b>306,792</b>
Net assets released from restriction used for purchase of equipment	<b>96,014</b>	<b>96,014</b>		
Net assets released from restriction	<b>(270,566)</b>		<b>(270,566)</b>	
Increase in net assets	<u><b>35,668,011</b></u>	<u><b>33,870,023</b></u>	<u><b>1,491,196</b></u>	<u><b>306,792</b></u>
Net assets, September 30, 2012	<u><b>\$ 197,862,113</b></u>	<u><b>\$ 187,215,454</b></u>	<u><b>\$ 2,890,743</b></u>	<u><b>\$ 7,755,916</b></u>

*See accompanying notes.*

# The William W. Backus Hospital

## Statements of Cash Flows

	<b>Year Ended September 30</b>	
	<b>2012</b>	<b>2011</b>
<b>Operating activities</b>		
Increase in net assets	\$ 35,668,011	\$ 3,251,015
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	18,006,195	16,971,187
Provision for uncollectible accounts	7,949,694	12,492,090
Change in pension funding and postretirement obligation	4,361,697	21,176,691
Transfer to affiliates	1,248,123	245,005
Purchase of investments – board designated, net	(11,430,363)	(8,811,993)
Change in net assets held in trust	(306,792)	26,296
Changes in operating assets and liabilities <i>(Note 16)</i>	(22,740,929)	(13,185,620)
Net cash provided by operating activities	32,755,636	32,164,671
<b>Investing activities</b>		
Purchase of investments – held in trust, net	(2,096,637)	(1,089,625)
Net additions to property, plant, and equipment	(13,139,402)	(7,741,430)
(Increase) decrease in other assets	(76,231)	61,572
Net cash used in investing activities	(15,312,270)	(8,769,483)
<b>Financing activities</b>		
Principal payments on long-term debt and capital lease obligations	(2,165,194)	(2,074,347)
Change in deferred financing costs and amortization of bond premium	(44,693)	(45,102)
Change in net assets held in trust	306,792	(26,296)
Transfer to affiliates	(1,248,123)	(245,005)
Net cash used in financing activities	(3,151,218)	(2,390,750)
Net increase in cash and cash equivalents	14,292,148	21,004,438
Cash and cash equivalents at beginning of year	93,136,217	72,131,779
Cash and cash equivalents at end of year	\$ 107,428,365	\$ 93,136,217

*See accompanying notes.*

# The William W. Backus Hospital

## Notes to Financial Statements

September 30, 2012

### **1. Significant Accounting Policies**

#### **Organization**

The William W. Backus Hospital (the Hospital), a voluntary association incorporated under the General Statutes of the State of Connecticut, is a wholly-owned subsidiary of Backus Corporation (the sole member). The Board of Directors of Backus Corporation elects a Board of Trustees that has control of the operations of the Hospital. Refer to Note 9 for further discussion of related party transactions.

The financial statements include the operations of Backus Medical Center Condominium Association, Inc. (the Association). All intercompany transactions have been eliminated in consolidation.

#### **Affiliation**

Backus Corporation, the parent corporation and sole member of the Hospital, has entered into an affiliation agreement with Hartford HealthCare Corporation dated August 17, 2012. The completion of the affiliation shall be subject to certain conditions, including regulatory approvals. Upon completion, Hartford HealthCare Corporation will become the sole corporate member of Backus Corporation. Backus Corporation will continue as the parent of the Hospital which will remain a separate legal entity.

#### **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### **Regulatory Matters**

The Hospital is required to file annual operating information with the State of Connecticut Department of Public Health, Office of Health Care Access (OHCA).

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**1. Significant Accounting Policies (continued)**

**Cash Equivalents**

The Hospital considers all highly liquid time deposits, commercial paper, and money market mutual funds purchased with a maturity at date of acquisition of three months or less to be cash equivalents.

**Assets Whose Use Is Limited**

The Board of Trustees has designated certain unrestricted funds, including principal and income, for construction and other purposes. The President and Chief Executive Officer of the Hospital may, after consultation with the Chairman, Vice Chairman, or the Board of Trustees, use board-designated funds, if required, to meet short-term operating cash requirements of the Hospital. Assets whose use is limited also include assets obtained through a financing arrangement with the State of Connecticut Health and Educational Facilities Authority (the Authority), as more fully explained in Note 8. The portion of those amounts required for funding current liabilities is included in current assets. The carrying amounts reported in the balance sheets are stated at fair value.

**Accounts Receivable and Net Patient Service Revenue**

Accounts receivable result from health care services provided by the Hospital. The amount of the allowance for uncollectible accounts is based on management's assessment of historical and expected net collections, business and economic conditions, trends in Medicare and Medicaid health care coverage and other collection indicators.

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

**Investments**

Marketable securities are classified as trading securities. Investments in debt and equity securities with readily determinable fair values are reported at fair value based on quoted market prices. Investment income or loss (including realized gains and losses on investments, interest and dividends) and the change in the net unrealized gains and losses are included in the excess of revenues over expenses unless the income or loss is restricted by the donor.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**1. Significant Accounting Policies (continued)**

**Inventories of Supplies**

Inventories of supplies are stated at the lower of cost (first-in, first-out method), or market.

**Property, Plant, and Equipment**

Property, plant, and equipment are stated on the basis of cost. The Hospital provides for depreciation using the straight-line method in amounts sufficient to depreciate the cost of its assets over their estimated useful lives.

**Temporarily and Permanently Restricted Net Assets**

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

**Nonoperating Gains and Losses**

Activities other than those in connection with providing health care services are considered to be nonoperating. Nonoperating gains and losses primarily consist of income on invested funds.

**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 operations and changes in net assets as net assets released from restrictions, which is included in other operating revenue. Donor-restricted contributions whose restrictions are met within the same year as received are classified as unrestricted contributions in the accompanying financial statements.

**General and Professional Liability Self-Insurance**

The Hospital has adopted the policy of self-insuring the deductible portion of its general and professional liability insurance coverage. The deductible limits are \$1,000,000 per claim and

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**1. Significant Accounting Policies (continued)**

**General and Professional Liability Self-Insurance (continued)**

\$5,000,000 annually for 2012 and 2011. Management accrues its best estimate of ultimate losses for both reported claims and claims incurred but not reported. The Hospital maintains a revocable trust for purposes of funding malpractice or comprehensive general liability losses.

**Excess of Revenues Over Expenses**

The statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from the excess of revenues over expenses (the performance indicator), consistent with industry practice, equity transfers from affiliates, both temporarily and permanently restricted donations and investment income, changes in perpetual trust arrangements and the change in pension funding and postretirement obligations.

**Income Taxes**

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code), and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Association is a taxable entity; however, any taxes are immaterial to the financial statements of the Hospital taken as a whole.

**Adoption of New Authoritative Pronouncements**

In January 2010, the Financial Accounting Standards Board (FASB) issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements*. ASU 2010-06 amended Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, to clarify certain existing fair value disclosure requirements and require a number of additional disclosures, which were adopted in 2010, with the exception of the requirement to present changes in Level 3 measurements on a gross basis, which was delayed until 2012. In 2012, the Hospital adopted the remainder of ASU 2010-06. The adoption of this guidance did not have a significant impact on the Hospital's financial statements.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**1. Significant Accounting Policies (continued)**

**Adoption of New Authoritative Pronouncements (continued)**

In August 2010, the FASB issued Accounting Standards Codification (“ASC”) 954-605, *Measuring Charity Care for Disclosure*. ASC 954-605 requires that the level of charity care provided be presented based on the direct and indirect costs of the charity services provided. ASC 954-605 also requires separate disclosure of the amount of any cash reimbursements received for providing charity care. ASC 954-605 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The adoption of this guidance has no impact on the consolidated financial statements.

In August 2010, the FASB issued ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*. ASU 2010-24 addresses the diversity in the accounting for medical malpractice and similar liabilities and their related anticipated insurance recoveries by health care entities that mostly have netted insurance recoveries against the accrued liability, although some have presented the anticipated insurance recovery and the liability on a gross basis. The amendments to ASC 954 clarify that a health care entity should not net insurance recoveries against a related claim liability; the amount of the claim liability should be determined without consideration of insurance recoveries. The Hospital adopted the required components of this guidance in 2012. As a result of the adoption of this standard, the Hospital increased other non-current assets and employee related obligations and self-insured professional liability by approximately \$5,304,894.

In July 2011, the FASB issued ASU 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts*. The guidance requires certain health care entities to present the bad debt expense associated with patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) rather than as an operating expense. The guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011, with early adoption permitted. The Hospital elected to early adopt ASU 2011-07 and has applied its provisions to the consolidated financial statements. The adoption of this guidance has no impact on excess of revenue over expenses or net assets.

**Reclassifications**

Certain reclassifications were made to the 2011 financial statements in order that they may be consistent with the current year presentation.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**2. Revenues from Services to Patients**

Net patient service revenue for the years ended September 30, 2012 and 2011 consists of the following:

	<b>Year Ended September 30</b>	
	<b>2012</b>	<b>2011</b>
Gross patient service revenue	<b>\$ 615,524,464</b>	\$ 604,060,585
Deductions:		
Allowances	<b>(326,751,789)</b>	(327,123,232)
Provision for uncollectible accounts	<b>(7,949,694)</b>	(12,492,090)
Charity care (at charges)	<b>(5,552,920)</b>	(5,004,135)
	<b>(340,254,403)</b>	(344,619,457)
	<b>\$ 275,270,061</b>	\$ 259,441,128

Patient accounts receivable are recorded when patient services are performed. Differences between amounts received from most third-party payors and the established billing rates of the Hospital are accounted for as allowances.

Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, the Hospital considers historical trends and any known future environmental factors to estimate the appropriate allowance for uncollectible accounts and provision for uncollectible accounts. Management regularly reviews data about major payor sources of revenue in evaluating the sufficiency of the allowance. For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and records an allowance if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to have financial difficulties that make collection of amounts due unlikely). For receivables associated with self pay patients (including both patients without insurance and patients with deductible and copayments due for which third-party coverage exists for part of the bill), the Hospital records a significant provision for uncollectible accounts in the period of service on the basis of its past experience which indicates a high level of non-payment. The difference between either standard rates or negotiated discount rates and the amounts actually collected after reasonable collection efforts have been exhausted, is charged off against the allowance for uncollectible accounts.

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

### 2. Revenues from Services to Patients (continued)

The Hospital's allowance for uncollectible accounts decreased by approximately \$3,475,000 in 2012 due to improved collections as well as a new policy whereby uninsured patients receive a discount equal to the average of the three lowest negotiated rates. Under the new policy, the discounted amount would no longer be included in allowance for uncollectible accounts (since self-pay accounts are significantly reserved for) and instead is included in the contractual allowance.

The Hospital recognizes net patient service revenue for patients with third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on a discounted basis as described on the Hospital's patient business services policy. Patient service revenue for the year ended September 30, 2012, net of contractual allowances and discounts, but before the provision for bad debts, recognized in the period is as follows:

	Third-Party Payors	Self-Pay	Total All Payors
Patient service revenue (net of contractual allowances and discounts)	\$ 272,485,726	\$ 10,734,029	\$ 283,219,755

During the years ended September 30, 2012 and 2011, the Hospital recorded approximately \$9,060,000 and \$2,065,000, respectively, of previously recognized estimated third-party payor settlements resulting in an increase in net patient service revenue.

Revenues from the Medicare and Medicaid programs accounted for approximately 32.1% and 9.4%, respectively, of the Hospital's net patient service revenue for the year ended September 30, 2012 and 29.5% and 9.9% for the year ended September 30, 2011. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations, except as noted in Note 13. While no regulatory inquiries are outstanding, 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. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

### 3. Charity Care and Community Benefit

It is the policy of the Hospital that medically necessary health care services should be available to all individuals regardless of their ability to pay. The Hospital provides free or discounted care based on the criteria of its charity care policy. The policy utilizes the generally recognized poverty income levels for the state to determine the level of financial assistance. For patients who do not apply or do not qualify, the uncollected amounts are recognized as bad debt expense. Because the Hospital does not pursue collection of amounts determined to be charity care, such services are not reported as net revenue.

Together, charity care and bad debt expense represent uncompensated care. The following table summarizes uncompensated care:

	<u>At Charge</u>	<u>Estimated Cost</u>
Charity care	\$ 5,552,920	\$ 2,276,697
Bad debt	7,949,694	3,259,375
Total uncompensated care, September 30, 2012	<u>\$ 13,502,614</u>	<u>\$ 5,536,072</u>
Charity care	\$ 5,004,135	\$ 2,201,819
Bad debt	12,492,090	5,496,520
Total uncompensated care, September 30, 2011	<u>\$ 17,496,225</u>	<u>\$ 7,698,339</u>

Estimated cost is based on the ratio of cost to charges, as determined by Hospital-specific data.

In addition to charity care provided to patients, the Hospital supports programs that improve the health and wellness of the community. The Hospital partnered with Norwich Technical High School for a program called "Life Happens". Based on a survey of the students, topics of concern included anxiety, depression, suicide and healthy eating. The Hospital provided speakers and education to the students and the parents to address these issues. The Hospital also sponsored a Multicultural Health Fair. The Fair was attended by Hospital staff, visitors and the community who were given handouts and fact sheets that offered background information, communication and respect styles, birth customs, and gender and end-of-life issues for the 23 represented cultures. The Hospital also owns and operates a Mobile Health Resource Center which travels to various locations in eastern Connecticut offering health education, counseling and screenings.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**4. Promises to Give**

Included in pledges receivable at September 30 are the following unconditional promises to give expected to be collected within a year.

	<u>2012</u>	<u>2011</u>
BackusCare campaign	\$ 24,646	\$ 45,546
Other	7,077	57,077
Unconditional promises to give before unamortized discount	<u>31,723</u>	102,623
Less unamortized discount and allowance		<u>(1,412)</u>
	<u>\$ 31,723</u>	<u>\$ 101,211</u>

**5. Investments**

Investment income and gains (losses) are comprised of the following for the years ended September 30:

	<u>2012</u>	<u>2011</u>
Unrealized gains (losses) in investments	\$ 10,067,106	\$ (5,813,831)
Realized gains on investments	823,335	4,650,170
Interest and dividend income	2,164,471	1,959,569
Other investment income	12,000	12,600
Investment fees	<u>(365,321)</u>	<u>(226,561)</u>
	<u>\$ 12,701,591</u>	<u>\$ 581,947</u>

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**5. Investments (continued)**

The market value of assets whose use is limited at September 30 is set forth in the following table:

	<u>2012</u>	<u>2011</u>
Board designated:		
Cash and cash equivalents	\$ 40,445,730	\$ 41,525,574
Mutual funds	45,050,366	37,251,516
Common stocks	17,114,732	12,925,056
Government bonds	10,801,121	12,811,596
Corporate bonds	3,456,816	924,660
	<u>\$116,868,765</u>	<u>\$ 105,438,402</u>
Held by trustee:		
Cash and cash equivalents	\$ 4,670,638	\$ 24,668,758
Mutual funds	12,669,133	2,327,261
Common stock	5,330,409	292,470
Corporate bonds	4,889,188	
Government bonds	2,345,973	731,506
Hedge funds	129,725	
Real estate	84,932	58,432
Commodities	55,066	
	<u>\$ 30,175,064</u>	<u>\$ 28,078,427</u>

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) provides guidance on investment decisions and endowment expenditures for nonprofit organizations. The Board of Trustees of the Hospital has interpreted UPMIFA as requiring the preservation of the fair value of the original gift at the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, the Hospital classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment, (b) the original value of the subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**5. Investments (continued)**

The primary objective of the endowment fund is to provide long-term support for the Hospital's capital and operating programs. The Hospital's investment goals are to maximize total return (capital appreciation, dividends and interest) while also protecting the Hospital's inflation-adjusted value over time. The Hospital's assets are diversified across multiple asset classes (e.g., common stocks, bonds and cash) to achieve an optimal balance between risk and return and between current income and capital appreciation. The investment program is structured to offer reasonably high probability of generating a real return of 5% per year over a period of five to ten years to protect the real inflation-adjusted value of assets and to meet the spending requirements. The Investment Committee reviews investment policies annually to determine if changes need to be made due to changing market conditions or other factors.

Management evaluates endowment spending in light of capital replacement and expansion plans. The spending policy does not apply a prescribed rate of spending in a given year, but does consider the following factors in making determinations to appropriate or accumulate donor restricted endowment funds:

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

Endowment assets are donor-restricted gifts which are meant to provide a permanent source of income to the Hospital and are included in permanently restricted net assets. Any deficits are funded with available temporarily restricted or unrestricted funds so as to maintain the corpus. Subsequent positive market returns replace the deficits.

The activity for the year ended September 30, 2012 is as follows:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at beginning of year	\$ 417,004	\$ 5,396,859	\$ 5,813,863
Investment return:			
Investment income		99,346	99,346
Net appreciation (realized and unrealized)		600,643	600,643
Earnings reclassified	699,989	(699,989)	
Total investment return	699,989		699,989
Endowment net assets at end of year	\$ 1,116,993	\$ 5,396,859	\$ 6,513,852

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**5. Investments (continued)**

The activity for the year ended September 30, 2011 is as follows:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets at beginning of year	\$ 513,486	\$ 5,320,786	\$ 5,834,272
Investment return:			
Investment income		151,536	151,536
Net depreciation (realized and unrealized)		(176,945)	(176,945)
Earnings reclassified	(96,482)	96,482	
Total investment (loss) return	(96,482)	71,073	(25,409)
Contributions		5,000	5,000
Endowment net assets at end of year	\$ 417,004	\$ 5,396,859	\$ 5,813,863

**6. Fair Value of Financial Instruments**

For assets and liabilities required to be measured at fair value, the Hospital measures fair value based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are applied based on the unit of account from the Hospital's perspective. The unit of account determines what is being measured by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting pronouncements.

The Hospital follows a valuation hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad categories. Level one inputs are quoted market prices in active markets that are accessible at the measurement date. Level two inputs are observable, but not quoted in active markets. Level three inputs are unobservable and are used when little or no market data is available.

Fair value for Level 2 assets are 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 assets consist of asset backed and mortgage backed obligations held by the defined benefit plan which are priced using model-based valuations using market information that best represents the value at which the security could be sold.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**6. Fair Value of Financial Instruments (continued)**

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, the Hospital uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers nonperformance risk in its assessment of fair value.

Financial assets as of September 30, 2012 are classified in the table below:

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 110,394,667	\$ 413,222		\$ 110,807,889
Certificates of deposit		24,925,922		24,925,922
Money market funds	16,468,019	342,903		16,810,922
US government obligations (a)		13,147,094		13,147,094
Corporate bonds (b)		8,346,004		8,346,004
Equity securities	22,445,141			22,445,141
Mutual funds-equities (c)	11,626,733	9,391,931		21,018,664
Mutual funds-international equities (d)	7,896,018	267,348		8,163,366
Mutual funds-fixed income (e)		20,066,767		20,066,767
Mutual funds-alternatives (f)		8,470,702		8,470,702
Commodities		55,066		55,066
Hedge funds		129,725		129,725
Real estate (REIT)		84,932		84,932
Total	\$ 168,830,578	\$ 85,641,616	-	\$ 254,472,194

(a) Includes both Treasury bonds and Treasury stripped bonds.

(b) Includes both foreign and domestic corporate bonds.

(c) This category primarily represents investments in common stock or similar securities of high-quality, financially secure companies listed on principal exchanges.

(d) This category seeks long term growth of capital with at least 80% of its investments in international equity securities.

(e) This category seeks maximum current income primarily through investments in fixed income securities of varying maturities.

(f) This category targets total returns over the long-term as measured by the Consumer Price Index + 5%, investing in index funds and various stock.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**6. Fair Value of Financial Instruments (continued)**

Financial assets as of September 30, 2011 are classified in the table below:

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 95,941,634	\$ 852,014		\$ 96,793,648
Certificates of deposit		24,901,139		24,901,139
Money market funds	37,571,306	64,456		37,635,762
US government obligations (a)		13,543,102		13,543,102
Corporate bonds (b)		924,660		924,660
Equity securities	13,217,526			13,217,526
Mutual funds-equities (c)	8,773,825	9,707,473		18,481,298
Mutual funds-international equities (d)	8,140,798	219,147		8,359,945
Mutual funds-fixed income (e)		12,737,534		12,737,534
Real estate (REIT)		58,432		58,432
Total	<u>\$ 163,645,089</u>	<u>\$ 63,007,957</u>	-	<u>\$ 226,653,046</u>

(a) Includes both Treasury bonds and Treasury stripped bonds.

(b) Includes both foreign and domestic corporate bonds.

(c) This category primarily represents investments in common stock or similar securities of high-quality, financially secure companies listed on principal exchanges.

(d) This category seeks long term growth of capital with at least 80% of its investments in international equity securities.

(e) This category seeks maximum current income primarily through investments in fixed income securities of varying maturities.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**6. Fair Value of Financial Instruments (continued)**

The following table presents the Hospital's fair value hierarchy for defined benefit plan assets as of September 30, 2012. At September 30, 2012, Level 3 assets comprise approximately 0.1% of the Hospital Plan's total investment portfolio fair value.

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 9,832,723			\$ 9,832,723
Mutual funds-equity (a)	25,164,036	\$ 32,899,941		58,063,977
Mutual funds-international equity(b)	19,186,295			19,186,295
Mutual funds-fixed income (c)		10,942,532		10,942,532
Mutual funds-alternatives (d)		11,578,091		11,578,091
US Government obligations(e)		6,441,117		6,441,117
Corporate bonds (f)		16,196,047		16,196,047
Mortgage backed obligations		7,262,891	\$ 188,330	7,451,221
<b>Total</b>	<b>\$ 54,183,054</b>	<b>\$ 85,320,619</b>	<b>\$ 188,330</b>	<b>\$ 139,692,003</b>

- (a) This category primarily represents investments in common stocks or similar securities of high-quality, financially secure companies listed on principal exchanges.
- (b) This category seeks long term growth of capital with at least 80% of its investments in international equity securities.
- (c) This category seeks maximum current income primarily thorough investments in fixed income securities of varying maturities.
- (d) This category targets total returns over the long-term as measured by the Consumer Price Index + 5%, investing in index funds, and various stock and bond index funds.
- (e) Includes both Treasury bonds and Treasury stripped bonds.
- (f) Includes both foreign and domestic corporate bonds.

The following table presents reconciliation for all Level 3 assets measured at fair value for the period October 1, 2011 to September 30, 2012.

	<b>Mortgage Backed Obligations</b>
Beginning balance	\$ 180,660
Unrealized gains	7,670
<b>Total</b>	<b>\$ 188,330</b>

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**6. Fair Value of Financial Instruments (continued)**

The following table presents the Hospital's fair value hierarchy for defined benefit plan assets as of September 30, 2011. At September 30, 2011, Level 3 assets comprise approximately 0.2% of the Hospital Plan's total investment portfolio fair value.

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 10,173,248			\$ 10,173,248
Mutual funds-equity (a)	23,965,541	\$ 25,514,446		49,479,987
Mutual funds-international equity(b)	22,103,407			22,103,407
Mutual funds-fixed income (c)		9,778,303		9,778,303
US Government obligations(d)		6,597,822		6,597,822
Corporate bonds (e)		9,553,768		9,553,768
Mortgage backed obligations		7,777,727	\$180,660	7,958,387
Total	<u>\$ 56,242,196</u>	<u>\$ 59,222,066</u>	<u>\$ 180,660</u>	<u>\$ 115,644,922</u>

- (a) This category primarily represents investments in common stocks or similar securities of high-quality, financially secure companies listed on principal exchanges.
- (b) This category seeks long term growth of capital with at least 80% of its investments in international equity securities.
- (c) This category seeks maximum current income primarily thorough investments in fixed income securities of varying maturities.
- (d) Includes both Treasury bonds and Treasury stripped bonds.
- (e) Includes both foreign and domestic corporate bonds.

The following table presents reconciliation for all Level 3 assets measured at fair value for the period October 1, 2010 to September 30, 2011.

	Asset Backed Obligations	Mortgage Backed Obligations	Total
Beginning balance	\$ 250,065	\$ 88,920	\$ 338,985
Purchases		99,500	99,500
Unrealized gains (losses)	716	(7,760)	(7,044)
Sales	(250,781)		(250,781)
Total	<u>\$ -</u>	<u>\$180,660</u>	<u>\$ 180,660</u>

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**6. Fair Value of Financial Instruments (continued)**

The carrying amount of certain of the Hospital's financial instruments, including cash and cash equivalents and pledge receivables approximate fair value due to the relatively short maturities of such instruments. Fair values of investments are based on quoted market prices and are recorded on the balance sheets as such. Fair value of the long-term debt is estimated using discounted cash flow analysis which is based on the AAA insured bond rate at the Hospital's fiscal year end. The fair value of long-term debt is \$72,441,444 and \$70,878,867 at September 30, 2012 and 2011, respectively.

**7. Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes at September 30:

	<u>2012</u>	<u>2011</u>
General use	\$ 1,186,206	\$ 206,742
Health care services	1,055,363	789,466
Preventative care	227,207	193,861
Extraordinary nursing care	131,654	105,444
Nursing education	108,153	87,446
Free beds	103,979	8,066
Laboratory	78,181	8,522
	<u>\$ 2,890,743</u>	<u>\$ 1,399,547</u>

Income generated by permanently restricted net assets at September 30 is restricted to the following purposes:

	<u>2012</u>	<u>2011</u>
Income to be used:		
For general uses and purposes	\$ 6,912,331	\$ 6,605,539
To provide free beds	527,060	527,060
For laboratory	258,182	258,182
To provide extraordinary nursing care	48,203	48,203
For nursing education	10,140	10,140
	<u>\$ 7,755,916</u>	<u>\$ 7,449,124</u>

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**8. Long-term Debt**

A summary of long-term debt at September 30 is as follows:

	<b>2012</b>	<b>2011</b>
Tax-exempt Hospital Revenue Bonds:		
Series E, term maturities (\$7,515,000) from 2017 to 2022 at an interest rate of 5.00%	<b>\$ 7,515,000</b>	\$ 8,080,000
Series F, serial maturities (\$5,125,000) from 2013 to 2018, with interest rates of 4.00% to 4.25%, term maturities (\$22,125,000) from 2023 to 2035 with interest rates of 5.00% to 5.25%	<b>27,250,000</b>	28,000,000
Series G, serial maturities (\$17,080,000) from 2013 to 2026, with interest rates of 3.50% to 5.00%, term maturities (\$7,420,000) in 2035 at an interest rate of 5%	<b>24,500,000</b>	25,150,000
Other long-term debt:		
Mortgage, maturing May 1, 2025 with a fixed interest rate of 6.125%	<b>1,126,557</b>	1,183,176
Obligations under capital leases	<b>6,344,367</b>	1,379,926
	<b>66,735,924</b>	63,793,102
Add net unamortized bond premium	<b>667,276</b>	711,971
Less current portion	<b>(2,346,210)</b>	(2,115,360)
Long-term debt	<b>\$ 65,056,990</b>	\$ 62,389,713

The Master Indenture, as amended and supplemented by Supplemental Master Indenture No. 4, provides for, among other things, a pledge of the gross receipts, as defined, of the Hospital, restriction on the incurrence of certain indebtedness of the Hospital, and covenants regarding the Hospital's debt service coverage ratios, sale and lease of assets, and other covenants similar in financings of this type. The bonds are secured by the real property of the Hospital, including all buildings and equipment. Pursuant to the loan agreements, the Hospital is obligated to provide amounts which will be sufficient to enable the Authority to pay the principal and interest on the Series E, Series F and Series G bonds.

Series E bonds are subject to optional redemption prior to maturity. Series F bonds are subject to optional redemption prior to maturity. Series G bonds maturing after July 1, 2015 are subject to optional redemption prior to maturity.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**8. Long-term Debt (continued)**

Future minimum principal payments on long-term debt and future minimum principal payments and interest on capital leases during each of the next five fiscal years, and in the aggregate, are as follows:

	<b>Long-Term Debt</b>	<b>Capital Leases</b>
2013	\$ 2,105,440	\$ 802,524
2014	2,184,302	802,524
2015	2,303,411	778,179
2016	2,387,624	705,224
2017	2,482,423	705,224
Aggregate thereafter	48,928,357	8,301,039
	60,391,557	12,094,714
 Add net unamortized bond premium	 667,276	
Less interest		(5,750,347)
	\$ 61,058,833	\$ 6,344,367

The Hospital paid interest of \$3,340,832 and \$3,312,005 in 2012 and 2011, respectively. Interest incurred in 2012 and 2011 was \$3,276,169 and \$3,247,715, respectively.

In 2012 the Hospital entered into a twenty-year capital lease of \$5,108,015 with an interest rate of 6.06% for a building located at 582 Norwich Road, Plainfield, CT to be used for emergency, radiology and lab services. Under the terms of the lease, the Hospital has the option for two additional five year terms as well as an option to purchase the property. The outstanding balance on this capital lease at September 30, 2012 was \$5,058,182.

In 2010 the Hospital entered into a five-year capital lease of \$458,781 with an interest rate of 5.9% for a building located at 80 Route 32, Montville, CT, to be used for patient services. The outstanding balance on this capital lease at September 30, 2012 was \$246,383. Under the terms of the lease, the Hospital has the option to renew for five periods of five years each.

In 2010 the Hospital entered into a fixed rate commercial mortgage of \$1,250,000 for a period of fifteen years at a rate of 6.125%. The note is secured by real property located at 11 Stott Avenue, Norwich, CT.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**8. Long-term Debt (continued)**

In 2004, the Hospital entered into a twenty-year capital lease of \$1,094,640 with an interest rate of 4.875% for a building located at 151-163 Broadway, Colchester, CT to be used for patient services. The outstanding balance on this capital lease at September 30, 2012 is \$1,039,802.

Deferred financing costs are amortized over the life of the bonds which is substantially the same as using the effective interest method.

**9. Related Party Transactions**

The Hospital processes payroll and disbursements for several of its affiliated entities for which it is reimbursed. Reimbursements due to the Hospital at September 30, 2012 and 2011 were approximately \$562,000 and \$165,000, respectively.

**10. Retirement Benefit Plans**

Effective January 1, 2010, the Hospital amended its defined benefit pension plan to close the plan to new participants and to freeze accruals for the existing participants in favor of a defined contribution plan.

The defined contribution plan covers substantially all of the employees of the Hospital. Under the provisions of the plan, the Hospital will make non-elective contributions to the plan on behalf of each eligible employee in the amount of 3% of the employee's eligible earnings. The Hospital will also make a non-elective transition contribution equal to 3% of employee's eligible earnings for all employees who meet the transition participant criteria. The Hospital may also, at the discretion of the Board of Trustees, make an elective matching contribution at the end of the plan year based on the Hospital's financial performance. The cost recorded for the years ended September 30, 2012 and 2011 was \$4,675,303 and \$5,206,397, respectively.

The Hospital also provides noncontributory postretirement health care benefits to eligible retirees and to eligible spouses of retirees who retired prior to January 1, 1994. Subsequent to 1993, covered retirees contribute a percentage of the cost based on years of service. In addition, the Hospital sponsors a nonqualified pension benefit program. Included in other long-term liabilities at September 30, 2012 and 2011 are approximately \$1,455,000 and \$2,600,000, respectively related to the future obligation for the nonqualified benefits.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**10. Retirement Benefit Plans (continued)**

Included in unrestricted net assets at September 30 are the following amounts that have not yet been recognized in net periodic benefit cost:

	Pension Benefits		Postretirement Benefits	
	2012	2011	2012	2011
	<i>(In thousands)</i>			
Unrecognized actuarial (loss) gain	\$ (69,083)	\$ (64,522)	\$ 1,476	\$ 1,600
Unrecognized transition obligation			(242)	(565)
	\$ (69,083)	\$ (64,522)	\$ 1,234	\$ 1,035

The actuarial loss and transition obligation included in unrestricted net assets and expected to be recognized in net periodic benefit cost during the year ending September 30, 2012 are \$4,919,884 and \$241,957, respectively.

At September 30, 2011, the unfunded status of the pension plan is included in long-term liabilities in the amount of \$60,301,776. The unfunded status of the postretirement benefits is \$4,083,669, with \$435,510 included in short-term liabilities, and the remainder of \$3,648,159 included in long-term liabilities. At September 30, 2012, the unfunded status of the pension plan is included in long-term liabilities in the amount of \$61,486,044. The unfunded status of the postretirement benefits is \$3,882,076, with \$412,955 included in short-term liabilities, and the remainder of \$3,469,121 included in long-term liabilities.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**10. Retirement Benefit Plans (continued)**

The following table sets forth the funded status of the plans as of the measurement date of September 30, 2012 and 2011.

	Pension Benefits		Postretirement Benefits	
	2012	2011	2012	2011
	<i>(In thousands)</i>			
<b>Change in projected benefit obligation</b>				
Benefit obligation at beginning of year	\$ (175,946)	\$ (158,266)	\$ (4,083)	\$ (4,266)
Service cost			(1)	(4)
Interest cost	(7,981)	(7,963)	(178)	(207)
Change in assumptions	(22,583)	(12,536)	(216)	(147)
Actuarial gain (loss)	118	(2,006)	184	113
Benefits paid	5,214	4,825	412	428
Benefit obligation at end of year	<u>\$ (201,178)</u>	<u>\$ (175,946)</u>	<u>\$ (3,882)</u>	<u>\$ (4,083)</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	\$ 115,644	\$ 114,203		
Actual return on plan assets	21,162	(1,834)		
Contributions	8,100	8,100	\$ 412	\$ 428
Benefits paid	(5,214)	(4,825)	(412)	(428)
Fair value of plan assets at end of year	<u>\$ 139,692</u>	<u>\$ 115,644</u>	<u>\$</u>	<u>\$</u>
<b>Underfunded status</b>				
Accrued benefit liability recognized in the balance sheets	<u>\$ (61,486)</u>	<u>\$ (60,302)</u>	<u>\$ (3,882)</u>	<u>\$ (4,083)</u>
<b>Components of net periodic benefit cost</b>				
Service cost			\$ 1	\$ 4
Interest cost	\$ 7,981	\$ 7,963	178	207
Expected return on plan assets	(7,908)	(7,832)		
Net amortization and deferral	4,651	2,843	230	224
Net periodic benefit cost	<u>\$ 4,724</u>	<u>\$ 2,974</u>	<u>\$ 409</u>	<u>\$ 435</u>
Assumptions:				
Weighted-average assumptions used to determine benefit obligations:				
Discount rate	3.80%	4.60%	3.80%	4.60%
Weighted-average assumptions used to determine net periodic benefit cost:				
Discount rate	4.60	5.10	4.60	5.10
Expected long-term rate of return on plan assets	6.75	6.75		

The accumulated benefit obligation at September 30, 2012 and 2011 was \$201,178,047 and \$175,946,699, respectively.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**10. Retirement Benefit Plans (continued)**

The asset allocations for the retirement plan at the end of 2012 and 2011 and the target allocation by asset category are as follows:

Asset Category	Target Allocation		Percentage of Plan Assets	
	Minimum	Maximum	2012	2011
US Equity Large Cap	20%	50%	37%	34%
US Equity Small Cap		15	5	5
International Equity	10	30	14	15
Core Fixed Income	20	60	44	46
Total			<b>100%</b>	<b>100%</b>

The Hospital Plan's investment policy includes target asset allocations percentages as shown above. The investment objective for the Hospital Plan is to produce a total rate of return (net of fees) that meets or exceeds the actuarial return assumption used for funding purposes, while generally striving to minimize significant variations in annual contribution levels through investment diversification. Investment return assumptions are developed through a multi-step process using external economic research including industry surveys and published economic research combined with internal economic scenario analysis, historical market returns and correlation trends.

Information about the expected cash flows for both plans is as follows:

	Pension Benefits	Postretirement Benefits
Expected employer contributions for 2013	\$ 8,100,000	\$ 412,955
Estimated future benefit payments:		
2013	6,182,497	412,955
2014	6,785,494	401,888
2015	7,330,485	380,032
2016	7,771,301	358,037
2017	8,269,818	336,252
2018-2022	49,972,063	1,372,745

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**10. Retirement Benefit Plans (continued)**

Assumed healthcare cost trend rates for 2012 are as follows:

Health care trend rate assumed for next year	7.00%
Rate to which the cost rate trend rate is assumed to decline (the ultimate trend rate)	5.00%
Year that the rate reaches the ultimate trend rate	2015

A one-percentage-point change in assumed health care cost trend rates would have the following effects on the postretirement benefit plan:

	<b>One-Percentage-Point Increase</b>	<b>Decrease</b>
	<i>(In thousands)</i>	
Effect on total of service and interest cost components	\$ 1	\$ (1)
Effect on postretirement benefit obligation	\$ 2	\$ (2)

**11. Property, Plant, and Equipment**

Property, plant, and equipment at September 30 consist of the following:

	<b>2012</b>	<b>2011</b>
Land and land improvements	\$ 4,862,121	\$ 4,862,121
Buildings and leasehold improvements	129,515,253	125,984,685
Equipment	104,187,422	98,557,288
Construction in process (2012 estimated cost to complete \$1,389,000)	1,747,654	1,365,773
Less accumulated depreciation	<u>(148,957,964)</u>	<u>(140,786,203)</u>
	<b><u>\$ 91,354,486</u></b>	<b><u>\$ 89,983,664</u></b>

The net unamortized value of internally developed software was \$388,314 at September 30, 2011. Amortization expense for the years ended September 30, 2012 and 2011 was \$388,314 and \$596,429, respectively.

The Hospital wrote off approximately \$6,941,684 of fully depreciated assets in 2012.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**11. Property, Plant, and Equipment (continued)**

The Hospital leases space to be used for patient services. One year remains on the initial term, with two five-year renewal options available at the discretion of the Hospital. Rent expense for the years ended September 30, 2012 and 2011 was \$755,190 and \$655,574, respectively.

The Hospital leases various types of equipment with annual payments ranging from \$91 to \$49,000. Expenses as a result of these leases were approximately \$270,000 and \$362,000 for the years ended September 30, 2012 and 2011, respectively

Future minimum lease payments under the above leases during each of the next five years were as follows:

2013	\$ 785,063
2014	209,216
2015	147,346
2016	36,950
2017	23,565
Thereafter	1,920
	<u>\$ 1,204,060</u>

**12. 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 agreements. The mix of gross accounts receivable from patients and third-party payors at September 30 is as follows:

	<u>2012</u>	<u>2011</u>
Medicare	32%	26%
Self pay	21	23
Health Maintenance Organizations	15	17
Anthem Blue Cross/Blue Shield	15	15
Medicaid	8	10
Commercial	6	5
Other state agencies	3	4
	<u>100%</u>	<u>100%</u>

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**13. Contingencies**

There have been malpractice claims that fall within the Hospital's partially self-insured program (see Note 1) which have been asserted against the Hospital. In addition, there are known incidents that have occurred through September 30, 2012, that may result in the assertion of claims. Hospital management, in conjunction with its consulting actuaries, has accrued its best estimate of these contingent losses.

Hospital management believes that it may not have conformed to all applicable laws and regulations regarding certain arrangements with outside parties. An internal investigation is underway and management has estimated and accrued a liability related to this matter. Except for this matter, Hospital management believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of any potential wrongdoing.

The Hospital is a party to various lawsuits incidental to its business. Management believes that the lawsuits will not have a material adverse effect on the Hospital's financial position or results of operations.

At September 30, 2012, approximately 22% of the Hospital's employees were covered by collective bargaining agreements.

**14. Other Operating Revenues**

Electronic Health Record (EHR) Program

Certain health care providers can earn incentive payments between 2011 and 2016 from Medicare and Medicaid for establishing an EHR system and maintaining its meaningful use. The Hospital recognizes income when it is reasonably assured that it is in compliance with the program criteria. The Hospital has included \$2,777,416 in other operating revenue related to the program for fiscal year 2012, including \$737,160 received from Medicaid. The estimate for the Medicare program is based on cost report data which is subject to audit and the amounts recognized are subject to change. The Hospital's attestation of compliance with the meaningful use criteria is subject to audit by the Federal or State government or its designee.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**14. Other Operating Revenues (continued)**

Other operating revenues consist of the following:

	<b>Year Ended September 30</b>	
	<b>2012</b>	<b>2011</b>
EHR income	<b>\$ 2,777,416</b>	
Cafeteria sales	<b>1,166,526</b>	\$ 1,102,713
Rental income	<b>1,025,861</b>	1,336,398
Grants	<b>614,920</b>	578,977
Condominium income	<b>492,179</b>	412,106
Fee income	<b>454,529</b>	398,731
Child care	<b>398,545</b>	391,976
Purchase discounts	<b>370,943</b>	269,594
Interest	<b>249,145</b>	165,642
Miscellaneous	<b>224,255</b>	192,061
	<b>\$ 7,774,319</b>	<b>\$ 4,848,198</b>

**15. Functional Expenses**

The Hospital provides inpatient medical and surgical, outpatient, psychiatric and emergency care services to residents of eastern Connecticut. Expenses related to providing these services are as follows:

	<b>Year Ended September 30</b>	
	<b>2012</b>	<b>2011</b>
Health care services	<b>\$ 199,189,567</b>	\$ 188,038,846
General and administrative	<b>57,263,709</b>	51,760,982
Fundraising	<b>200,940</b>	193,923
	<b>\$ 256,654,216</b>	<b>\$ 239,993,751</b>

Costs for interest and insurance are included in general and administrative expenses. Malpractice insurance is included in health care services.

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**16. Cash Flows**

Changes in operating assets and liabilities at September 30 include the following:

	<u>2012</u>	<u>2011</u>
(Increase) decrease in assets:		
Accounts receivable	\$ (7,591,912)	\$ (14,106,271)
Pledges receivable	69,488	84,655
Due from affiliates	(397,894)	496,941
Inventories of supplies, prepaid expenses, and other	(1,550,490)	(251,633)
(Decrease) increase in liabilities:		
Due to third-party reimbursement agencies	(5,652,284)	8,463,850
Accounts payable	(742,115)	(210,687)
Employee related obligations	(4,552,508)	(5,322,115)
Interest payable and other accrued liabilities	1,870,890	(3,233,379)
Salaries and wages, payroll taxes, and taxes withheld from payroll	136,013	460,084
Self-insured professional liability	(4,539,196)	339,430
Other liabilities	209,079	93,505
Changes in operating assets and liabilities	<u>\$ (22,740,929)</u>	<u>\$ (13,185,620)</u>

**17. Subsequent Events**

The Hospital evaluates the impact of subsequent events, which are events that occur after the balance sheet date but before the financial statements are issued, for potential recognition in the financial statements as of the balance sheet date for the year ended September 30, 2012. The Hospital evaluated subsequent events through December 14, 2012, which is the date the financial statements were issued. No events occurred that require disclosure or adjustment to the combined financial statements.

## Supplementary Information

## Report of Independent Auditors on Supplementary Information

Board of Trustees  
The William W. Backus Hospital

We have audited the financial statements of The William W. Backus Hospital for the year ended September 30, 2012, and have issued our report thereon dated December 14, 2012 which contained an unqualified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The consolidating balance sheet and statement of operations are presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Ernst & Young LLP*

December 14, 2012

# The William W. Backus Hospital

## Consolidating Balance Sheet

September 30, 2012

	<b>The William W. Backus Hospital</b>	<b>Backus Medical Center Condominium Association, Inc.</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 107,428,365			\$ 107,428,365
Assets whose use is limited – required for current liabilities	7,433,046			7,433,046
Accounts receivable, less allowance for uncollectible accounts	32,015,340			32,015,340
Pledges receivable	31,723			31,723
Due from affiliates	564,613		\$ (2,572)	562,041
Inventories of supplies	3,548,865			3,548,865
Prepaid expenses and other	3,309,657	\$ 20,641		3,330,298
Total current assets	154,331,609	20,641	(2,572)	154,349,678
Assets whose use is limited:				
Board-designated investments	116,868,765			116,868,765
Held by trustee	30,175,064			30,175,064
Total assets whose use is limited	147,043,829			147,043,829
Less assets whose use is limited – required for current liabilities	7,433,046			7,433,046
	139,610,783			139,610,783
Property, plant, and equipment, net	91,354,486			91,354,486
Deferred financing costs	1,754,758			1,754,758
Other assets	5,881,388			5,881,388
Total assets	\$ 392,933,024	\$ 20,641	\$ (2,572)	\$ 392,951,093

The William W. Backus Hospital  
Consolidating Balance Sheet (continued)

September 30, 2012

	The William W. Backus Hospital	Backus Medical Center Condominium Association, Inc.	Eliminations	Consolidated
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable – trade	\$ 9,176,344			\$ 9,176,344
Salaries and wages, payroll taxes, and taxes withheld from payroll	6,802,151			6,802,151
Other accrued liabilities	6,890,306			6,890,306
Employee related obligations	3,834,900			3,834,900
Due to third-party reimbursement agencies	1,193,235			1,193,235
Interest payable	714,869			714,869
Due to affiliates		\$ 2,572	\$ (2,572)	
Current portion of long-term debt	2,346,210			2,346,210
Total current liabilities	30,958,015	2,572	(2,572)	30,958,015
Other liabilities:				
Long-term debt and capital lease obligations	65,056,990			65,056,990
Employee related obligations	71,736,171			71,736,171
Self-insured professional liability	9,685,357			9,685,357
Due to third-party reimbursement agencies	17,000,185			17,000,185
Other	652,262			652,262
	164,130,965			164,130,965
Net assets:				
Unrestricted	187,197,385	18,069		187,215,454
Temporarily restricted	2,890,743			2,890,743
Permanently restricted	7,755,916			7,755,916
Total net assets	197,844,044	18,069		197,862,113
Total liabilities and net assets	\$ 392,933,024	\$ 20,641	\$ (2,572)	\$ 392,951,093

The William W. Backus Hospital  
Consolidating Statement of Operations

Year Ended September 30, 2012

	<b>The William W. Backus Hospital</b>	<b>Backus Medical Center Condominium Association, Inc.</b>	<b>Eliminations</b>	<b>Consolidated</b>
Operating revenues:				
Net patient service revenue	\$ 283,219,755			\$ 283,219,755
Provision for uncollectible accounts	(7,949,694)			(7,949,694)
Net patient service revenue less provision for uncollectible accounts	275,270,061			275,270,061
Other operating revenues	7,282,140	\$ 511,256	\$ (19,077)	7,774,319
Net assets released from restriction	174,552			174,552
	<u>282,726,753</u>	<u>511,256</u>	<u>(19,077)</u>	<u>283,218,932</u>
Operating expenses:				
Salaries, wages, and professional fees	114,140,337			114,140,337
Payroll taxes and other fringe benefits	32,008,290			32,008,290
Supplies, insurance, and other	88,731,046	511,256	(19,077)	89,223,225
Depreciation and amortization	18,006,195			18,006,195
Interest	3,276,169			3,276,169
	<u>256,162,037</u>	<u>511,256</u>	<u>(19,077)</u>	<u>256,654,216</u>
Operating income	26,564,716			26,564,716
Nonoperating gains and (losses):				
Income from investments	12,701,591			12,701,591
Contributions	147,058			147,058
Other	(29,536)			(29,536)
Excess of revenues over expenses	<u>\$ 39,383,829</u>			<u>\$ 39,383,829</u>

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