

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**AND OTHER FINANCIAL INFORMATION**  
**SEPTEMBER 30, 2012 AND 2011**

# JOHNSON MEMORIAL HOSPITAL

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## INDEPENDENT AUDITORS' REPORT

Board of Directors  
**Johnson Memorial Hospital**

We have audited the accompanying consolidated balance sheets of Johnson Memorial Hospital (the Hospital) as of September 30, 2012 and 2011, and the related consolidated statements of operations, 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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, 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 Johnson Memorial Hospital as of September 30, 2012 and 2011, and the results of its operations, changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming the Hospital will continue as a going concern. As described in Note 1, the Hospital has experienced recurring losses from operations, debt covenant violations, and had current liabilities that exceeded current assets by \$415,876 as of September 30, 2012. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

*Marcum LLP*

Hartford, CT  
January 8, 2013



# JOHNSON MEMORIAL HOSPITAL

## CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2012 AND 2011

	2012	2011
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 819,327	\$ 913,716
Patients accounts receivable, net of allowances for uncollectible accounts, \$2,702,000 in 2012 and \$2,534,000 in 2011	8,403,783	7,541,440
Insurance and other receivables	222,529	1,415,420
Inventories	1,254,591	1,216,495
Prepaid expenses and other current assets	853,062	977,701
<b>Total Current Assets</b>	<u>11,553,292</u>	<u>12,064,772</u>
<b>Assets Whose Use is Limited</b>		
Beneficial interests in perpetual trusts	3,616,492	3,165,722
Restricted cash and board designated investments	363,097	517,407
Investments permanently restricted by donor	843,587	843,587
<b>Total Assets Whose Use is Limited</b>	<u>4,823,176</u>	<u>4,526,716</u>
<b>Other Assets</b>		
Property, plant and equipment, net	19,606,953	21,489,519
Investments in joint ventures	3,106,905	2,856,651
Deferred financing costs, net	356,845	540,827
Other noncurrent assets	445,000	445,000
<b>Total Other Assets</b>	<u>23,515,703</u>	<u>25,331,997</u>
	<u>\$ 39,892,171</u>	<u>\$ 41,923,485</u>

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

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATED BALANCE SHEETS (CONTINUED)**

**SEPTEMBER 30, 2012 AND 2011**

	2012	2011
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Trade accounts payable	\$ 3,400,553	\$ 2,676,050
Accrued payroll and related costs	2,172,911	1,911,006
Current portion of payments due under plan of reorganization	997,500	1,323,916
Senior debt under revolving line of credit	3,504,213	4,651,186
Current portion of mortgage payable	342,500	342,500
Current portion of subordinated debt	100,583	94,035
Current portion of capital lease obligations	61,820	180,261
Estimated amounts due to third-party reimbursement agencies	1,272,580	1,266,304
Other current liabilities	116,508	185,834
<b>Total Current Liabilities</b>	<b>11,969,168</b>	<b>12,631,092</b>
<b>Long-Term Obligations</b>		
Due to affiliate corporations	1,817,168	2,065,421
Payments due under plan of reorganization - less current portion	5,505,445	6,132,010
Mortgage payable - less current portion	11,816,250	12,158,750
Subordinated debt - less current portion	231,464	333,115
Other long-term debt	1,300,000	--
Obligations under capital lease - less current portion	58,370	29,810
Self-insurance liabilities	1,141,100	1,575,812
Other liabilities	769,553	752,910
<b>Total Long-Term Obligations</b>	<b>22,639,350</b>	<b>23,047,828</b>
<b>Total Liabilities</b>	<b>34,608,518</b>	<b>35,678,920</b>
<b>Net Assets</b>		
Unrestricted	560,928	1,913,639
Temporarily restricted	262,646	321,617
Permanently restricted	4,460,079	4,009,309
<b>Total Net Assets</b>	<b>5,283,653</b>	<b>6,244,565</b>
	<b>\$ 39,892,171</b>	<b>\$ 41,923,485</b>

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

# JOHNSON MEMORIAL HOSPITAL

## CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011
<b>Operating Revenue</b>		
Net patient service revenue	\$ 69,334,641	\$ 64,582,295
Grant and other income	308,671	609,548
Net assets released from restriction	25,552	33,994
<b>Total Operating Revenue</b>	<b>69,668,864</b>	<b>65,225,837</b>
<b>Expenses</b>		
Salaries	31,433,170	30,947,816
Employee benefits	7,370,190	7,495,713
Provision for uncollectible accounts	3,773,454	2,530,453
Professional fees and outsourced staffing	3,365,845	3,557,873
Depreciation and amortization	3,213,542	3,277,534
Purchased services	3,631,422	4,042,617
Supplies, drugs and patient care	7,130,721	7,036,054
Leases and service contracts	1,675,437	1,555,727
Occupancy costs	3,111,685	2,812,952
Insurance	1,178,515	1,314,629
Other expenses	4,699,010	2,970,876
Interest	1,495,715	1,480,694
<b>Total Expenses</b>	<b>72,078,706</b>	<b>69,022,938</b>
<b>Loss from Operations</b>	<b>(2,409,842)</b>	<b>(3,797,101)</b>
<b>Nonoperating Revenue (Loss)</b>		
Investment income	177,006	123,908
Gain on sale of equipment	3,196	--
Equity earnings (loss) in joint ventures	250,254	(12,760)
	430,456	111,148
<b>Loss Before Reorganization Items</b>	<b>(1,979,386)</b>	<b>(3,685,953)</b>
<b>Reorganization Items</b>		
Gain on discharge of debt	--	1,094,678
<b>Deficiency of Revenues over Expenses</b>	<b>\$ (1,979,386)</b>	<b>\$ (2,591,275)</b>

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

# JOHNSON MEMORIAL HOSPITAL

## CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (DEFICIT)

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
<b>Unrestricted Net Assets</b>		
Deficiency of revenues over expenses	\$ (1,979,386)	\$ (2,591,275)
Net asset transfer from affiliate	74,638	--
Net assets released from restriction for purchase of property and equipment	<u>552,037</u>	<u>--</u>
<b>Change in Unrestricted Net Assets</b>	<u>(1,352,711)</u>	<u>(2,591,275)</u>
<b>Temporarily Restricted Net Assets</b>		
Grants and contributions	518,618	355,611
Net assets released from restriction	<u>(577,589)</u>	<u>(33,994)</u>
<b>Change in Temporarily Restricted Net Assets</b>	<u>(58,971)</u>	<u>321,617</u>
<b>Permanently Restricted Net Assets</b>		
Increase (decrease) in fair value of beneficial interests in perpetual trusts	<u>450,770</u>	<u>(117,521)</u>
<b>Change in Net Assets</b>	(960,912)	(2,387,179)
<b>Net Assets - Beginning</b>	<u>6,244,565</u>	<u>8,631,744</u>
<b>Net Assets - End</b>	<u>\$ 5,283,653</u>	<u>\$ 6,244,565</u>

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

# JOHNSON MEMORIAL HOSPITAL

## CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011
<b>Cash Flows From Operating Activities and Reorganization Items</b>		
Change in net assets	\$ (960,912)	\$ (2,387,179)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Gain on discharge of debt	--	(1,094,678)
Depreciation and amortization	3,213,542	3,277,534
Accretion of asset retirement obligation	16,643	18,693
Provision for uncollectible accounts	3,773,454	2,530,453
Equity (earnings) loss in joint ventures	(250,254)	12,760
Gain on disposal of equipment	(3,196)	--
Change in net unrealized gains on investments	(450,770)	117,521
Changes in assets and liabilities:		
Patient accounts receivable	(4,635,797)	(1,547,565)
Insurance and other receivables	1,192,891	(1,104,689)
Prepaid expenses and other current assets	124,639	350,829
Inventories	(38,096)	(61,912)
Restricted cash and board designated investments	154,310	445,263
Other noncurrent assets	--	(445,000)
Restricted grants and contributions	(518,618)	(355,611)
Accounts payable and accrued expenses	724,503	(2,939,711)
Accrued payroll and related costs	261,905	(1,412,602)
Estimated amounts due to third-party reimbursement agencies	6,276	194,829
Other liabilities	(69,326)	630,834
Self-insurance liabilities	(434,712)	42,296
Payments due under plan of reorganization	(952,981)	(541,415)
<b>Net Cash Provided by (Used in) Operating Activities and Reorganization Items</b>	<b>1,153,501</b>	<b>(4,269,350)</b>
<b>Cash Flows From Investing Activities</b>		
Capital expenditures	(1,143,798)	(808,294)
<b>Net Cash Used in Investing Activities</b>	<b>(1,143,798)</b>	<b>(808,294)</b>

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

# JOHNSON MEMORIAL HOSPITAL

## CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011
<b>Cash Flows From Financing Activities</b>		
Restricted grants and contributions	\$ 518,618	\$ 355,611
Principal payments on mortgage and subordinated debt	(437,603)	(837,865)
Proceeds from other long-term debt	1,300,000	--
Net (payments on) proceeds from revolving line of credit	(1,146,973)	651,186
Principal payments on capital lease obligations	(89,881)	(267,840)
Payments (to) from affiliates	<u>(248,253)</u>	<u>1,688,230</u>
<b>Net Cash (Used in) Provided by Financing Activities</b>	<u>(104,092)</u>	<u>1,589,322</u>
<b>Net Change in Cash and Cash Equivalents</b>	(94,389)	(3,488,322)
<b>Cash and Cash Equivalents - Beginning</b>	<u>913,716</u>	<u>4,402,038</u>
<b>Cash and Cash Equivalents - Ending</b>	<u>\$ 819,327</u>	<u>\$ 913,716</u>
<b>Supplemental Disclosures of Cash Flow Information</b>		
Cash paid for interest	<u>\$ 1,036,354</u>	<u>\$ 1,025,272</u>
Cash paid for professional fees in connection with reorganization	\$ --	\$ (1,346,184)
Cash provided by (used in) operating activities	<u>1,153,501</u>	<u>(2,923,166)</u>
	<u>\$ 1,153,501</u>	<u>\$ (4,269,350)</u>

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

**JOHNSON MEMORIAL HOSPITAL**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011**

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**NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION**

***ORGANIZATION***

Johnson Memorial Hospital (the Hospital) is an acute care hospital located in Stafford Springs, Connecticut. The Hospital is licensed for 92 beds and provides a broad range of inpatient and outpatient services primarily throughout the Hartford and Tolland Connecticut counties. Admitting physicians are primarily practitioners in this same geographic area. The Hospital has controlling interests in Johnson Professional Associates, P.C. (JPA) and Johnson Memorial Hospital Development Fund, Inc. (Development). The Hospital is a subsidiary of Johnson Memorial Medical Center (the Corporation), a not-for-profit, non-stock holding company. The other subsidiaries of the Corporation are Johnson Health Care, Inc. (Health Care), Home & Community Health Services, Inc. (Home and Community) and Johnson Evergreen Corporation (Evergreen), which are not-for-profit companies, and WellCare, Inc., a taxable entity.

The Hospital's major accounting policies are as summarized below and in Note 2.

***EMERGENCE FROM BANKRUPTCY***

As a result of the Hospital's severe financial operating deficits, management determined it would be unable to pay its obligations in the normal course of business during fiscal year 2009 or service its debt in a timely fashion. On November 4, 2008, the Hospital, the Corporation and Evergreen, filed voluntary petitions for relief under Chapter 11 (Chapter 11 Proceedings) of the U.S. Bankruptcy Code (Bankruptcy Code) in the U.S. Bankruptcy Court for District of Connecticut, Hartford Division (Bankruptcy Court). This generally delayed payments of liabilities incurred prior to filing those petitions while the Hospital developed a plan of reorganization that was satisfactory to its creditors, and allowed it to continue as a going concern.

On August 11, 2010, the Bankruptcy Court confirmed the Hospital's plan of reorganization which was subject to the Hospital's satisfaction of a number of conditions precedent. One of the conditions precedent was that the Hospital, the Corporation, and Evergreen (collectively the Debtors) were required to obtain a line of credit of at least \$6 million. On September 30, 2010, the plan of reorganization became effective when the Debtors received financing under an \$8 million line of credit and all other material conditions precedent to the plan becoming binding were resolved. The Bankruptcy Court issued a final decree on December 29, 2010.

There was no change in control as the Hospital's Board of Directors immediately prior to the confirmation of the plan retained control upon emergence from the Chapter 11 proceedings. Therefore, the Hospital did not adopt fresh-start reporting.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

As of September 30, 2012 and 2011, liabilities compromised by the confirmed plan have been recorded at the present values of amounts to be paid, determined at the interest rate of 6.75%.

During the year ended September 30, 2011, management determined that the Hospital would not be eligible to receive electronic medical record stimulus funding. As of September 30, 2010, the Hospital recorded a liability of \$1,094,678 related to an estimate of the stimulus funding that would be payable to its creditors under the plan of reorganization. During the year ended September 30, 2011, the Hospital recorded a change in estimate to eliminate this liability which is reflected as a gain on discharge of debt in the 2011 consolidated statement of operations.

The Hospital's confirmed plan provided for the following:

*Secured Debt* - The Hospital's secured debt with a bank (secured by a first mortgage lien on land and buildings located in Stafford Springs, Connecticut and a blanket lien on all furniture, fixtures, and equipment) was reinstated as such maturity existed before any default, and is payable in quarterly installments of \$85,625 through January 1, 2048. The Hospital will also remain obligated as guarantor of the Corporation's and Evergreen's secured debt in the amounts of \$3,060,000 and \$14,419,102, respectively, as of September 30, 2012.

*Other Secured Debt* – The Hospital's loan to finance information technology equipment was restructured to be paid in 60 monthly installments of \$10,000, including interest. The carrying value of this compromised debt was \$332,047 and \$427,150 as of September 30, 2012 and 2011, respectively.

*Priority and Administrative Claims* – All priority and administrative claims will be paid as allowed by the Court.

*Trade and Other Miscellaneous Claims* - The holders of approximately \$11 million of trade and other miscellaneous claims are entitled to receive \$705,232 on the effective date, \$256,025 on the first anniversary of the effective date, \$488,775 on the second anniversary of the effective date and \$954,275 on the each of the third, fourth, and fifth anniversaries of the effective date. The distribution could increase if the Hospital receives electronic medical record stimulus funding or if there is a change in control.

The holders of approximately \$145,000 of convenience claims are entitled to receive 50% of their allowed claim. Unexpired leases and executory contracts not rejected by the Hospital are paid according to their original or negotiated terms.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

*Pension Benefit Guaranty Corporation (PBGC) Claims* - The PBGC was entitled to receive \$730,402 on the effective date, \$266,475 on the first anniversary of the effective date, \$508,725 on the second anniversary of the effective date and \$993,225 on the each of the third, fourth, and fifth anniversaries of the effective date. The distribution could increase if the Hospital receives electronic medical record stimulus funding, if there is a change in control, or if the Hospital receives litigation claim proceeds related to claims, rights or causes of action arising under Chapter 5 of the Bankruptcy Code.

The Hospital failed to make the initial payment of \$730,402 to the PBGC during the year ended September 30, 2011, but has made this payment as well as the payment of \$266,475 during the year ended September 30, 2012.

#### *AFFILIATION WITH SAINT FRANCIS CARE, INC.*

On July 12, 2012, the Hospital, along with the Corporation and Evergreen (collectively, the Johnson Entities) entered into an affiliation agreement with Saint Francis Care, Inc. (Saint Francis), a Hartford, Connecticut based health system, designed to establish a long-term stable relationship between the two systems, allowing them to work together to maintain and strengthen the Corporation's operating viability and the Hospital's presence in the community as a community hospital, expand the array of health care services available, support the Hospital's medical staff, and enhance the Corporation's efforts to fulfill its mission. Saint Francis made an initial payment to the Johnson Entities of \$1,300,000 on the date of the affiliation agreement and made an additional payment of \$1,050,000 on October 1, 2012, both payments to be used by the Johnson Entities to satisfy outstanding claims owed under the reorganization plan (the Plan) to the Pension Benefit Guaranty Corporation (PBGC) and the unsecured creditors in classes A6 and B6 of the Plan.

In addition, Saint Francis will have the option, at its sole discretion, to make future annual payments of \$2,050,000 on the first day of October from 2013 through 2015 and a payment of \$500,000 on the first day of October 2016. The Johnson Entities will use these additional payments to satisfy the payment of claims due on these dates under the Plan. Saint Francis is required to notify the Corporation by June 1 of each year whether it will make the next succeeding additional payment. All payments made by Saint Francis under this agreement will constitute an unsecured loan. This loan will be payable in the event that Johnson seeks the closing of an alternative transaction, but only if the proceeds of this alternative transaction exceed the amounts necessary to satisfy all other secured and unsecured debt owed by Johnson, or breaches the exclusivity provisions granted to Saint Francis in the agreement.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

In the event that the Johnson Entities breach the exclusivity provisions of the affiliation agreement, the Johnson Entities will be required to pay Saint Francis fees of \$250,000 for each payment made by Saint Francis to the Johnson Entities up to a maximum fee of \$1,000,000.

In connection with the \$1,300,000 initial payment, Saint Francis was provided with the right to appoint three members to the Boards of Directors of Johnson Memorial Medical Center, Johnson Memorial Hospital, and Johnson Evergreen Corporation. For each additional payment made by Saint Francis, it will be provided with the right to add one additional board member to the aforementioned boards of directors. Saint Francis will not have the right to appoint a majority of the members of any of the aforementioned boards until all of the payments have been made under the terms of the affiliation agreement. After Saint Francis has made all of these payments, it will have the right to appoint the majority of the members of the boards subject to any necessary governmental approvals.

The affiliation agreement provides Saint Francis with the right to cause the Johnson Entities to be merged with or into Saint Francis, to acquire all of the assets of the Johnson Entities, or to be the sole member of the Johnson Entities as long as Saint Francis assumes or satisfies all of the Johnson Entities' then-existing indebtedness.

The affiliation agreement requires the Johnson Entities to obtain the consent of Saint Francis prior to the occurrence of the following events: merger, dissolution, dilution of Saint Francis' board representation, incurrence of certain additional debt, prepayment of debt, creation of liens, entering into lease obligations in excess of \$1 million, the sale or disposition of properties in excess of defined thresholds, distributions of cash, or the addition or termination of any material clinical service.

Saint Francis will provide medical leadership in the Hospital's oncology program, infectious disease program, hospitalist program and management services in both case management and psychiatry which should help the Hospital attract additional volume. It is anticipated that the Hospital will also utilize the informational technology systems of Saint Francis once they have been upgraded in 2014. This should allow the Hospital to recognize economic synergies and enhance its operational performance.

In addition, debt agreements with People's United Bank (People's) and Healthcare Finance Group (HFG) have been modified on the date of the affiliation (see Note 9) to reflect changes in covenant calculations.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

#### *GOING CONCERN*

The accompanying financial statements have been prepared assuming that the Hospital will continue as a going concern. For the year ended September 30, 2012, the Hospital experienced a loss of \$1,979,386 and had current liabilities that exceeded current assets by \$415,876. The Hospital is a party to a credit agreement that requires certain financial and non financial covenants be maintained. These covenants require that the Hospital and its parent and affiliates maintain a fixed charge coverage ratio that was not maintained during 2012 (see Note 9). These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

It is the plan of management to ensure that the Hospital continues as a going concern. Management believes that the aforementioned affiliation agreement with Saint Francis will assist in addressing the continuing operational deficiencies to help ensure that the Corporation and Hospital continue as going concerns.

The Hospital's continuation as a going concern is ultimately dependent upon its future financial performance, which will be affected by general economic, competitive and other factors, many of which are beyond the Hospital's control. There can be no assurance that the Hospital's plans to ensure continuation as a going concern will be successful.

#### *PRINCIPLES OF CONSOLIDATION AND PRESENTATION*

The accompanying consolidated financial statements include the accounts of Johnson Memorial Hospital, Johnson Professional Associates, P.C., and Johnson Memorial Hospital Development Fund, Inc. (Development). Johnson Professional Associates, P.C. and Development are entities in which the Hospital has a controlling financial interest. All inter-company accounts have been eliminated in consolidation.

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

##### *CONSOLIDATION*

ASC 810-25, *Consolidations*, requires a not-for-profit entity, among other things, to consolidate into its financial statements the financial results of another not-for-profit in which it has a controlling financial interest and to make certain disclosures. Reference is made to Note 2.

ASC 810-15 requires a for profit entity to be consolidated if an organization has the power through voting or similar rights to direct the economic activities of the entity.

##### *NET ASSET CATEGORIES*

To ensure observance of limitations and restrictions placed on the use of resources available to the Hospital, the accounts of the Hospital are maintained in the following net asset categories:

*Unrestricted* – Unrestricted net assets represent available resources which can be used for general operations of the Hospital. Included in unrestricted net assets are assets set aside by the Board of Directors.

*Temporarily Restricted* – The Hospital reports gifts of cash and other assets as 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 to unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in within the same year as received are reflected as unrestricted contributions in the accompanying statements of operations. At September 30, 2012 and 2011 the Hospital had temporarily restricted net assets of \$262,646 and \$321,617, respectively.

*Permanently Restricted* – Permanently restricted net assets represent contributions received with the donor restriction that the principal be invested in perpetuity and that income earned thereon is available for operations or a specific purpose.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

##### *USE OF ESTIMATES*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, including estimated uncollectible accounts receivable for services to patients, and liabilities, including estimated net settlements with third-party reimbursement agencies and professional liabilities, and disclosure of contingent assets and contingent liabilities at the date of the financial statements. Estimates also affect the amounts of revenues and expenses reported during the period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

##### *REGULATORY MATTERS*

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

##### *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 net assets 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 to unrestricted net assets.

##### *CASH AND CASH EQUIVALENTS*

The Hospital considers all highly liquid investments with remaining maturities of three months or less at date of purchase to be cash equivalents. Cash and cash equivalents are held at a limited number of financial institutions and at times, the amounts on deposit exceed insured limits.

##### *ACCOUNTS RECEIVABLE*

Patient accounts receivable result from the health care services provided by the Hospital and JPA. The amount of the allowance for uncollectible accounts is based upon 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. See Note 3 for additional information relative to net patient service revenue recognition and third-party payer programs.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

##### *INVENTORIES*

Inventories of drugs and supplies are stated at the lower of cost or market, determined using the first in first out method.

##### *INVESTMENTS*

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheets. Investment income or loss (including realized gains and losses on investments, interest and dividends) are included in the deficiency of revenues over expenses unless the income or loss is restricted by donor or law.

Unrealized gains and losses on investments on the Hospital's beneficial interest in perpetual trusts are recorded as changes in permanently restricted net assets.

##### *INVESTMENT IN JOINT VENTURES*

The Hospital has two joint ventures that it accounts for using the equity method. The changes in the Hospital's share in the equity of these joint ventures is recorded as a component of nonoperating revenue (loss) in the consolidated statements of operations.

##### *PROPERTY, PLANT AND EQUIPMENT*

Property, plant and equipment are recorded at cost. The Hospital provides for depreciation of property, plant and equipment and amortization of assets recorded under capital leases using the straight-line method in amounts sufficient to amortize the cost of the assets over their estimated useful lives ranging from 3 to 40 years.

Financial Accounting Standards Board ASC 410-20, *Accounting for Asset Retirement Obligations*, provides guidance on accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Asset retirement obligations include, but are not limited to, certain types of environmental issues which are legally required to be remediated upon an asset's retirement as well as contractually required asset retirement obligations. ASC 410-20 provides clarifying guidance on conditional asset retirement obligations. Conditional asset retirement obligations are obligations whose settlement may be uncertain. ASC 410-20's guidance requires such conditional asset retirement obligations to be estimated and recognized. Application of these pronouncements affects the Hospital with respect to required future asbestos remediation.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Conditional asset retirement obligations of \$324,553 and \$307,910 as of September 30, 2012 and 2011, respectively, were recorded in other liabilities on the balance sheets. These retirement obligations have been discounted at a rate of 6.75%. The undiscounted amounts of the obligations were \$346,000 at September 30, 2012 and 2011. There were no retirement obligations incurred or settled during 2012 or 2011. Reference is made to Note 14 regarding other environmental exposures.

#### *IMPAIRMENT OF LONG-LIVED ASSETS*

The Hospital records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. There were no impairment losses recorded in 2012 or 2011. Management believes that the Hospital will generate undiscounted cash flows that will at least hold the value in its long lived assets at their current carrying values and the economic synergies and additional volume anticipated through the affiliation agreement with Saint Francis are expected to help the Hospital improve its cash flows.

#### *NONOPERATING REVENUE (LOSS)*

Activities, other than in connection with providing health care services, are considered to be nonoperating. Nonoperating revenue (loss) consists primarily of income on invested funds, gains on sales of equipment and the changes in the Hospital's share of equity of the joint ventures accounted for under the equity method.

#### *DEFERRED FINANCING FEES*

Deferred financing costs, which were incurred in connection with the debt, are being amortized over the term of the related debt. Amortization expense for deferred financing costs amounted to \$183,981 for the years ended September 30, 2012 and 2011.

#### *DEFICIENCY OF REVENUE OVER EXPENSES*

The statements of operations and changes in net assets include the deficiency of revenue over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from the deficiency of revenue over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), and permanent transfers of assets to and from affiliates for other than goods and services.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

##### *INCOME TAXES*

The Hospital and Development are not-for-profit corporations as defined in Section 501(c)(3) of the Internal Revenue Code, and therefore are exempt from federal and state income taxes, except on net income derived from unrelated business activities. JPA is a professional corporation that has experienced losses since inception and accordingly, no provisions for federal or state income taxes have been recorded.

The Hospital accounts for uncertainty in income tax positions in the consolidated financial statements by applying a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Management has analyzed the tax positions taken and has concluded that as of September 30, 2012, there are no uncertain tax positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements. The Hospital, Development, and JPA are subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Management believes that these organizations are no longer subject to income tax examinations prior to 2009.

##### *ESTIMATED MEDICAL MALPRACTICE AND WORKERS' COMPENSATION COSTS*

The provision for estimated medical malpractice and workers' compensation claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

##### *ADVERTISING*

The Hospital expenses advertising costs as incurred. Advertising expenses for the years ended September 30, 2012 and 2011 were \$207,107 and \$154,129, respectively.

##### *BENEFICIAL INTEREST IN PERPETUAL TRUSTS*

The Hospital is the beneficiary of several trust funds. Although the principal balances in the trust funds are permanently restricted, the income earned on the trust funds is unrestricted. The 2012 unrealized gains from the trust funds were \$450,770 and the 2011 unrealized losses from the trust fund were \$117,521 and are included in changes in permanently restricted net assets.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

##### *RECOGNITION OF GRANT REVENUE*

Grants are generally considered to be exchange transactions in which the grantor requires the performance of specified activities. Entitlement to cost reimbursement grants is conditioned on the expenditure of funds in accordance with grant restrictions and, therefore, revenue is recognized to the extent of grant expenditures. Entitlement to performance based grants is conditioned on the attainment of specific performance.

##### *CHARITY CARE*

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge, or at amounts less than its established rates. The Hospital does not pursue collection of amounts determined to be charity care. For the year ended September 30, 2012 the charges and costs related to charity care were \$193,110 and \$77,541 and for the year ended September 30, 2011, the charges and costs related to charity care were \$465,815 and \$251,560, respectively.

##### *NEW ACCOUNTING PRONOUNCEMENTS*

##### *PRESENTATION OF INSURANCE CLAIMS AND RELATED INSURANCE RECOVERIES*

Effective October 1, 2011 and retrospectively for all periods presented, the Hospital adopted the provisions of ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*, which further clarifies that health care entities should not net insurance recoveries against the related claim liabilities. In connection with the Hospital's adoption of ASU 2010-24, the Hospital recorded the changes below in the accompanying consolidated balance sheet as of September 30, 2011. The \$185,834 increase as of September 30, 2011 represents the Hospital's workers' compensation claims covered by insurance for losses in excess of the maximum premium in the Hospital's retrospectively rated insurance policy.

The \$445,000 increase as of September 30, 2011 represents the Hospital's estimate of recoveries for certain claims by a fully insured professional liability insurance policy. The adoption of ASU 2010-24 had no impact on the Hospital's net assets, results of operations or cash flows.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

The following is a summary of the impact of the adoption of ASU 2010-24 on the Hospital's accompanying September 30, 2011 consolidated balance sheet:

	As originally reported	Adjustments for the adoption of ASU 2010-24	As currently reported
Insurance and other receivables	\$ 1,229,586	\$ 185,834	\$ 1,415,420
Other noncurrent assets	--	445,000	445,000
Total assets	41,292,651	630,834	41,923,485
Other current liabilities	--	185,834	185,834
Other liabilities	307,910	445,000	752,910
Total liabilities	35,048,086	630,834	35,678,920

#### *MEASURING CHARITY CARE FOR DISCLOSURE*

Self-pay revenues are derived primarily from patients who do not have any form of health care coverage. The revenues associated with self-pay patients are generally reported at the Hospital's gross charges. The Hospital evaluates these patients, after the patient's medical condition is determined to be stable, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid or other governmental assistance programs, as well as the Hospital's policy for charity care. The Hospital provides care without charge to certain patients that qualify under its charity care policy. For the years ended September 30, 2012 and 2011, the Hospital estimates that its costs of care provided under its charity care programs approximated \$78,000 and \$252,000, respectively.

The Hospital's management estimates its costs of care provided under its charity care programs utilizing a calculated ratio of costs to gross charges multiplied by the Hospital's gross charity care charges provided. The Hospital's gross charity care charges include only services provided to patients who are unable to pay and qualify under the Hospital's charity care policy. To the extent the Hospital receives reimbursement through the various governmental assistance programs in which it participates to subsidize its care of indigent patients, the Hospital does not include these patients charges in its cost of care provided under its charity care program. Additionally, the Hospital does not report a charity care patient's charges in revenues or in the provision for uncollectible accounts as it is the Hospital's policy not to pursue collection of amounts related to these patients.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Previously, the Hospital reported its estimates of services provided under its charity care program based on gross charges. In connection with the Hospital's adoption of ASU 2010-23, *Measuring Charity Care for Disclosure*, amounts previously reported for care provided under its charity care programs have been restated to reflect the Hospital's estimates of its direct and indirect costs of providing these services. This change had no impact on the Hospital's results of operations.

#### ***BAD DEBTS***

In July 2011, the FASB issued ASU 2011-07, *Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts*, which requires 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 with enhanced footnote disclosures on the policies for recognizing revenue and assessing bad debts, in addition to qualitative and quantitative information about changes in the allowance for doubtful accounts. The pronouncement will be adopted during the fiscal year ending September 30, 2013. The Hospital is evaluating the effect of the pronouncement on its financial statements.

#### ***RECLASSIFICATIONS***

Certain amounts reported in the prior year's financial statements have been reclassified to conform to the current year's financial statements.

#### ***SUBSEQUENT EVENTS***

The Hospital evaluates the impact of subsequent events, 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 or for disclosure in the notes to the consolidated financial statements. The Hospital evaluated events occurring subsequent to September 30, 2012 through January 8, 2013, the date on which the accompanying financial statements were available to be issued. During this period, there were no subsequent events that required disclosure or recognition in the financial statements.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 2 – CONSOLIDATED ENTITIES

JPA is a medical practice that is controlled by the Hospital. Although the Hospital does not have direct ownership interests in JPA, the Hospital has a controlling voting interest in the Board of JPA, thus enabling the Hospital to control the economic activities of JPA. Also, the Hospital provides funding to JPA to fund its operating losses.

Johnson Memorial Hospital Development Fund, Inc. is a not-for-profit organization that raises funds for the Hospital and other affiliates in which the Hospital has a controlling financial interest by virtue of control of its board of directors and the fact that substantially all of Development's assets are for the use of the Hospital.

#### NOTE 3 – NET REVENUE FROM SERVICES TO PATIENTS AND CHARITY CARE

The following table summarizes net revenue from services to patients during the years ended September 30, 2012 and 2011:

	2012	2011
Gross patient service revenue	\$ 161,562,823	\$ 159,461,324
Contractual and other allowances	(92,150,641)	(94,627,469)
Charity care provided free of charge - at cost	<u>(77,541)</u>	<u>(251,560)</u>
Net patient service revenue	<u>\$ 69,334,641</u>	<u>\$ 64,582,295</u>

Patient accounts receivable and revenues are recorded when patient services are performed. Amounts received from most payers are different from the established billing rates of the Hospital, and these differences are accounted for as allowances.

The following table represents the percentages of net revenue received from payers during the years ended September 30, 2012 and 2011:

	2012	2011
Medicare	38%	39%
Medicaid	9%	7%
Third parties	39%	41%
Other	14%	13%

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 3 – NET REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE (CONTINUED)

Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital. The State of Connecticut has announced reductions in the State's Disproportionate Share Reimbursement Program for fiscal year 2013. Management estimates that these reductions will reduce net patient service revenue by approximately \$600,000 during the year ending September 30, 2013.

The significant concentrations of net accounts receivable for services to patients by payer at September 30, 2012 and 2011 follow:

	2012	2011
Medicare	26%	27%
Medicaid	10%	11%
Third parties	38%	38%
Other	26%	24%

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. 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. The Hospital believes that it is in compliance with all applicable laws and regulations. Cost reports for the Hospital, which serve as a basis for final settlement with government payors, have been settled by final settlement through 2009 for Medicare and 2007 for Medicaid. Other years remain open for settlement.

The Hospital has agreements with various Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, the HMOs make fee-for-service payments to the Hospital for certain covered services based upon discounted fee schedules.

The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to the established policies of the Hospital. Essentially, these policies define charity services as those services for which no payment is possible. In assessing a patient's inability to pay, the Hospital utilizes the generally recognized poverty income levels for the State, but also includes certain cases where incurred charges are significant when compared to incomes. These charges are not included in net patient service revenues for financial reporting purposes.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

#### NOTE 4 – ASSETS WHOSE USE IS LIMITED

The composition of assets whose use is limited, which include beneficial interests in perpetual trusts, cash restricted for payment of workers compensation claims and permanently restricted investments by donors are set forth in the following table. Investments are stated at fair value.

	2012		2011	
	Cost	Fair Value	Cost	Fair Value
Cash and cash equivalents	\$ 1,206,684	\$ 1,206,684	\$ 1,538,157	\$ 1,538,157
Money market funds	858,411	858,411	10,419	10,419
Mutual funds - equity	94,306	102,080	143,353	147,632
Mutual funds - fixed	106,078	108,381	99,162	95,857
Collective funds - equity	40,979	71,167	28,470	47,842
Collective funds - fixed	32,941	34,524	35,973	36,615
Investment grade taxable bonds	744,647	859,176	764,010	872,421
Global high yield bonds	109,113	104,948	109,654	97,005
Equities				
U.S. large cap	836,560	886,042	1,070,874	1,086,711
U.S. mid cap	192,297	241,423	384,883	369,163
U.S. small cap	65,729	62,424	62,686	50,196
International developed	84,912	86,026	197,341	169,415
Real estate	61,886	70,285	--	--
Tangible assets - commodities	147,088	131,605	4,687	5,283
	<u>\$ 4,581,631</u>	<u>\$ 4,823,176</u>	<u>\$ 4,449,669</u>	<u>\$ 4,526,716</u>

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 4 – ASSETS WHOSE USE IS LIMITED (CONTINUED)

Investment income and gains (losses) on investments recorded in the consolidated statements of operations for the years ended September 30 are below.

	2012	2011
Income		
Interest and dividend income	\$ 215,020	\$ 162,970
Realized (losses) gains on sales of securities	(2,797)	243
	212,223	163,213
Less investment management fees	(35,217)	(39,305)
Net investment gains	<u>\$ 177,006</u>	<u>\$ 123,908</u>

#### NOTE 5 – FAIR VALUE MEASUREMENTS

Assets and liabilities recorded at fair value in the financial statements are categorized, for disclosure purposes, based upon whether the inputs used to determine their fair values are observable or unobservable utilizing a three-level fair value hierarchy that prioritizes the inputs used to measure assets and liabilities at fair value. Level inputs are as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Hospital has the ability to access on the reporting date.

Level 2 – Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specific (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 – Inputs that are unobservable for the asset or liability.

The fair values of Level 1 securities were determined through quoted market prices, while fair values of Level 2 securities were determined primarily through prices obtained from third party pricing sources, where quoted market prices for such securities were not available. The fair values of Level 3 securities were determined primarily through information obtained from the relevant counterparties for such investments, as information on which these securities' fair values are based is generally not readily available in the market.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

#### NOTE 5 – FAIR VALUE MEASUREMENTS (CONTINUED)

The following table summarizes fair value measurements, by level, at September 30, 2012 and 2011, for all assets and liabilities which are measured at fair value on a recurring basis in the financial statements:

	Level 1	Level 2	Level 3	Total
September 30, 2012				
Beneficial interests in perpetual trusts				
Money market funds	\$ 858,411	\$ --	\$ --	\$ 858,411
Mutual funds - equity	102,080	--	--	102,080
Mutual funds - fixed	108,381	--	--	108,381
Collective funds - equity	--	--	71,167	71,167
Collective funds - fixed	--	--	34,524	34,524
Investment grade				
taxable bonds	859,176	--	--	859,176
Global high yield bonds	104,948	--	--	104,948
Equities				
U.S. large cap	886,042	--	--	886,042
U.S. mid cap	241,423	--	--	241,423
U.S. small cap	62,424	--	--	62,424
International developed	86,026	--	--	86,026
Real estate	70,285	--	--	70,285
Tangible assets-commodities	--	--	131,605	131,605
Total beneficial interests in perpetual trusts	3,379,196	--	237,296	3,616,492
Restricted cash and board designated investments				
	363,097	--	--	363,097
Investments permanently restricted by donor				
	843,587	--	--	843,587
	<u>\$ 4,585,880</u>	<u>\$ --</u>	<u>\$ 237,296</u>	<u>\$ 4,823,176</u>

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

#### NOTE 5 – FAIR VALUE MEASUREMENTS (CONTINUED)

	Level 1	Level 2	Level 3	Total
September 30, 2011				
Beneficial interests in perpetual trusts				
Cash and cash equivalents	\$ 177,163	\$ --	\$ --	\$ 177,163
Money market funds	10,419	--	--	10,419
Mutual funds - equity	147,632	--	--	147,632
Mutual funds - fixed	95,857	--	--	95,857
Collective funds - equity	--	--	47,842	47,842
Collective funds - fixed	--	--	36,615	36,615
Investment grade				
taxable bonds	872,421	--	--	872,421
Global high yield bonds	97,005	--	--	97,005
Equities				
U.S. large cap	1,086,711	--	--	1,086,711
U.S. mid cap	369,163	--	--	369,163
U.S. small cap	50,196	--	--	50,196
International developed	169,415	--	--	169,415
Real estate	5,283	--	--	5,283
Total beneficial interests in perpetual trusts	3,081,265	--	84,457	3,165,722
Restricted cash and board designated investments				
	517,407	--	--	517,407
Investments permanently restricted by donor				
	843,587	--	--	843,587
	<u>\$ 4,442,259</u>	<u>\$ --</u>	<u>\$ 84,457</u>	<u>\$ 4,526,716</u>

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 5 – FAIR VALUE MEASUREMENTS (CONTINUED)

The following is a reconciliation of Level 3 assets for which significant unobservable inputs were used to determine fair value:

	Beneficial Interests in <u>Perpetual Trusts</u>
Balance at October 1, 2010	\$ 90,279
Change in fair value	<u>(5,822)</u>
Balance at September 30, 2011	84,457
Purchases of investments	147,088
Change in fair value	<u>5,751</u>
Balance at September 30, 2012	<u>\$ 237,296</u>

#### NOTE 6 – RESTRICTED ENDOWMENTS

The Hospital's endowments consist of donor-restricted endowment funds and beneficial interests in perpetual trusts. Net assets associated with endowment funds are classified and reported based on donor-imposed restrictions.

The Hospital's Board of Directors has interpreted the Connecticut Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor restricted endowment funds, absent explicit donor stipulations to the contrary. This does not apply to beneficial interests in perpetual trusts where the fair value of the investments is the basis for the amount recorded as permanently restricted net assets.

As a result of the interpretation of UPMIFA, the Hospital classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and, if applicable, (c) accumulations to the permanent endowment made in accordance with the related gift's donor instructions. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as unrestricted net assets based on the donors' stipulations and those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard for expenditures as proscribed by UPMIFA.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 6 – RESTRICTED ENDOWMENTS (CONTINUED)

In accordance with UPMIFA, the Hospital considers 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 Hospital and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Hospital
- (7) The investment policies of the Hospital

#### ***RETURN OBJECTIVES AND RISK PARAMETERS***

For the permanently restricted endowment funds, the bank, acting in its capacity as trustee, determines and directs the investment policy and asset allocation. For the unrestricted endowment funds, the Hospital's Board of Directors has adopted investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. The Hospital expects these endowment funds, over time, to provide an average rate of return that exceeds the rate of inflation annually. Actual returns in any given year may vary from this amount.

#### ***STRATEGIES EMPLOYED FOR ACHIEVING OBJECTIVES***

To satisfy its long-term rate-of-return objectives, the Hospital relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Hospital targets a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints.

#### ***SPENDING POLICY AND HOW THE INVESTMENT OBJECTIVES RELATE TO THE SPENDING POLICY***

The Hospital has a policy of evaluating the spending decisions for each endowment fund based upon the intentions of the donors and specific contractual agreements. In determining the annual amount to be spent, the Hospital considers the long-term expected return on its endowment. The spending policy is designed to limit spending to the expected long-term real rate of return. The annual distribution from the endowment funds is expected to be contained within a range of the trusts' market value that is consistent with the Hospital's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

#### NOTE 6 – RESTRICTED ENDOWMENTS (CONTINUED)

*ENDOWMENT NET ASSET COMPOSITION BY TYPE OF FUND AS OF SEPTEMBER 30, 2012 AND 2011:*

	Unrestricted	Permanently Restricted	Total
September 30, 2012			
Donor-restricted endowment funds	\$ --	\$ 843,587	\$ 843,587
Beneficial interests in perpetual trusts	--	3,616,492	3,616,492
	\$ --	\$ 4,460,079	\$ 4,460,079
September 30, 2011			
Donor-restricted endowment funds	\$ --	\$ 843,587	\$ 843,587
Beneficial interests in perpetual trusts	--	3,165,722	3,165,722
	\$ --	\$ 4,009,309	\$ 4,009,309

*CHANGES IN ENDOWMENT NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011*

	Unrestricted	Permanently Restricted	Total
September 30, 2012			
Endowment net assets, beginning	\$ --	\$ 4,009,309	\$ 4,009,309
Investment return:			
Investment income	177,006	--	177,006
Net unrealized gains	--	450,770	450,770
Total investment return	177,006	450,770	627,776
Appropriation of endowment assets for expenditure	(177,006)	--	(177,006)
Endowment net assets, ending	\$ --	\$ 4,460,079	\$ 4,460,079

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

#### NOTE 6 – RESTRICTED ENDOWMENTS (CONTINUED)

	Unrestricted	Permanently Restricted	Total
September 30, 2011			
Endowment net assets, beginning	\$ <u>          --</u>	\$ <u>4,126,830</u>	\$ <u>4,126,830</u>
Investment return:			
Investment income	120,877	--	120,877
Net unrealized losses	<u>          --</u>	<u>(117,521)</u>	<u>(117,521)</u>
Total investment return	<u>120,877</u>	<u>(117,521)</u>	<u>3,356</u>
Appropriation of endowment assets for expenditure	<u>(120,877)</u>	<u>          --</u>	<u>(120,877)</u>
Endowment net assets, ending	<u>\$ <u>          --</u></u>	<u>\$ <u>4,009,309</u></u>	<u>\$ <u>4,009,309</u></u>

#### NOTE 7 – TEMPORARILY RESTRICTED AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets of \$262,646 as of September 30, 2012 consist of \$31,803 remaining on the unexpended proceeds of a \$350,000 grant received from Northeast Regional Radiation Oncology Network, Inc. (NRRON) to be used for the construction of the new infusion center in Enfield, CT, \$67,313 from the Hospital's 100<sup>th</sup> anniversary fund raising events, and \$163,530 to be utilized for the replacement of a generator. The Hospital has a 25% ownership interest in NRRON (\$3,055,158 and \$2,819,068 at September 30, 2012 and 2011, respectively) that is included in investments in joint ventures on the consolidated balance sheets.

Permanently restricted net assets of \$4,460,079 and \$4,009,309 at September 30, 2012 and 2011, respectively, represent assets to be held in perpetuity, the income from which is expendable to support health care services and the general operations of the Hospital.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 8 – PROPERTY, PLANT AND EQUIPMENT

The components of cost and the related accumulated depreciation comprising property, plant and equipment as of September 30, 2012 and 2011 are as follows:

	2012	2011
Land	\$ 406,997	\$ 406,997
Land improvements	1,558,879	1,237,587
Building and improvements	24,468,554	24,224,435
Fixed and movable equipment	<u>32,571,220</u>	<u>33,042,503</u>
	59,005,650	58,911,522
Less accumulated depreciation	<u>(39,398,697)</u>	<u>(37,422,003)</u>
	<u>\$ 19,606,953</u>	<u>\$ 21,489,519</u>

Depreciation expense for property, plant and equipment amounted to \$2,985,675 and \$3,002,181 for the years ended September 30, 2012 and 2011, respectively. Included within depreciation and amortization expense on the statements of operations is amortization for capital leased assets of \$43,886 and \$91,372 for the years ended September 30, 2012 and 2011, respectively (see Note 10).

#### NOTE 9 – DEBT

##### *MORTGAGE NOTE PAYABLE*

On August 1, 2006, the Hospital entered into a \$13,700,000 commercial construction mortgage loan with a bank. The loan was used to finance the expansion and renovation of the emergency department, three nursing units, the psychiatric unit, and two medical and surgical units, and to refinance the Hospital's existing loans (collectively, the Project). In December 2007, the loan was converted to a term loan, which is guaranteed by the United States Department of Agriculture (USDA) through the USDA Rural Development Community Facilities Program. The term loan calls for equal quarterly principal payments of \$85,625 over 40 years and will mature on January 1, 2048. Fifty percent of the loan bears interest at the bank's five year cost of borrowing plus 1.50% and fifty percent of the loan bears interest at the three month LIBOR plus 1.25%. The interest rates in effect at September 30, 2012 were 6.63% and 1.71%, respectively.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 9 – DEBT (CONTINUED)

As of September 30, 2012, there was a balance of \$12,158,750 due on the mortgage.

The Hospital is required to meet certain financial covenants under the mortgage. On September 27, 2010, the mortgage was modified and the bank waived all defaults that occurred prior to that date. The quarterly debt service coverage ratio requirement was also modified. The Hospital did not comply with this covenant for the quarter ended December 31, 2010 and on March 30, 2011, the bank waived this default.

In 2006, the Hospital entered into a loan to finance certain information systems equipment at an interest rate of 5.5%. The Hospital failed to make payments in accordance with the loan terms. The Hospital's loan to refinance information equipment was restructured to be paid in 60 monthly installments of \$10,000. The present value of the settlement value of this loan was \$332,047 and \$427,150 at September 30, 2012 and 2011, respectively.

Future minimum payments by year and in the aggregate for the mortgage loan and subordinated debt were as follows at September 30, 2012:

2013	\$ 443,083
2014	450,087
2015	457,578
2016	352,445
2017	342,500
Thereafter	<u>10,445,104</u>
	<u>\$ 12,490,797</u>

#### **REVOLVING LOAN**

In September 2010, the Hospital, along with several affiliates (the Borrowers), entered into a Revolving Loan and Security Agreement (senior debt under revolving line of credit) with a lender for an amount not to exceed the lesser of \$8 million or the maximum borrowing base (85% of the book value of all eligible receivables). Under the original agreement, amounts outstanding bear interest at the greater of the 3 month LIBOR rate plus 4.25% or 5.75% payable monthly in arrears. The Hospital has granted the lender a security interest in accounts receivable. On July 12, 2012, this agreement was amended as a result of the affiliation between the Johnson Entities and Saint Francis to extend the line of credit expiration date to September 27, 2014.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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### NOTE 9 – DEBT (CONTINUED)

The Hospital is jointly and severally liable for the full payment of the debt under this agreement, including any debt incurred by Evergreen and Home & Community Health Services, Inc.

As of September 30, 2012, there were outstanding borrowings of \$3,504,213 under the Loan and Security Agreement and \$2,125,207 was available for future borrowings.

The Borrowers are subject to a number of covenants and restrictions under the Revolving Loan and Security Agreement. These include the following affirmative and negative covenants: provision of monthly, quarterly and annual financial information, adequate insurance coverage, notice of certain events and changes, change in ownership or management, restrictions on indebtedness and lease agreements, sale of assets, protection of collateral and financial covenants prepared on a consolidated basis for the Borrowers including cash flow and debt service coverage ratio requirements.

During 2011, the Borrowers failed to comply with various covenants under the Revolving Loan and Security Agreement. This resulted in the lender imposing an interest penalty of 4% beginning January 1, 2011 that remained in place until July 12, 2012. During the year ended September 30, 2012, the Borrowers failed to comply with the fixed charge coverage ratio covenant and management is working with the lender to modify this covenant requirement. In the event that the Borrowers don't comply with this or any other covenant, the loan will remain payable on demand.

#### ***OTHER DEBT***

The other long-term debt of \$1,300,000 as of September 30, 2012 represents the amount owed to Saint Francis under the terms of the affiliation agreement. Reference is made to Note 1.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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### NOTE 10 – LEASE OBLIGATIONS

#### *CAPITAL LEASES*

The Hospital has entered into non-cancelable capital lease obligations for certain equipment. The cost of the assets is being amortized over the useful lives of the assets or the shorter of the respective lease term or useful life if the asset does not transfer to the Hospital at the end of the lease term and is summarized as of September 30, 2012 and 2011 are as follows:

	2012	2011
Medical and other equipment	\$ 497,904	\$ 913,226
Less, accumulated amortization	<u>(129,296)</u>	<u>(258,127)</u>
	<u>\$ 368,608</u>	<u>\$ 655,099</u>

Future minimum lease payments under the capital leases, together with the present value of future minimum lease payments, as of September 30, 2012 are as follows:

2013	\$ 67,292
2014	19,681
2015	18,108
2016	18,108
2017	<u>16,599</u>
Total future minimum lease payments	139,788
Less, amounts representing interest	<u>19,598</u>
Present value of future minimum lease payments	120,190
Less current portion	<u>61,820</u>
	<u>\$ 58,370</u>

#### *OPERATING LEASES*

The Hospital leases various computer equipment, medical equipment and office space under operating leases, which expire at various dates through 2015. Rent expense under the operating leases was \$2,268,594 and \$2,058,478 in 2012 and 2011, respectively. These leases have various terms and conditions. The Hospital subleases land to an affiliated corporation under a month-to-month lease arrangement. Sublease income was \$180,000 for each of the fiscal years ended September 30, 2012 and 2011.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 10 – LEASE OBLIGATIONS (CONTINUED)

Minimum future rental commitments on these non-cancelable operating leases with initial or remaining terms of more than one year as of September 30, 2012 are as follows:

2013	\$ 688,454
2014	434,628
2015	<u>196,591</u>
	<u>\$ 1,319,673</u>

#### NOTE 11 – EMPLOYEE BENEFIT PLANS

The Hospital formerly had a defined benefit pension plan that covered certain employees. Pursuant to the plan of reorganization, the Pension Benefit Guaranty Corporation assumed control of the defined benefit plan effective September 1, 2011.

The Hospital has a defined contribution plan (the Plan) whereby all employees who have attained the age of 21 and completed one year of employment (1,000 hours of service) are eligible to participate and become fully vested after 5 years. Annually, the Hospital may contribute a defined amount of employees' salaries to the Plan. Effective January 1, 2011, the Hospital suspended the matching of non-union employee contributions; it continued to pay the match on union employees up until June 2012, at which time only those union employees that had been grandfathered in the Plan were matched. The total expense incurred by the Hospital for contributions was \$249,482 in 2012. The total expense incurred by the Hospital for contributions made to the Plan was \$454,629 in 2011. Management indicated that this match will be reinstated.

#### NOTE 12 – SELF-INSURANCE CLAIMS

There have been medical malpractice and workers' compensation claims that 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 has accrued its best estimate of these contingent losses. Other claims may be asserted arising from services provided to patients or workers' compensation incidents in the past. Hospital management has provided reserves for these contingent liabilities.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### **NOTE 13 – PROFESSIONAL, GENERAL LIABILITY AND WORKERS' COMPENSATION INSURANCE**

For claims incurred through August 31, 2009, the Hospital was self-insured for professional liability and general liability claims, under a claims made plan, which covered the Corporation's entire health system. The Corporation has an excess umbrella claims made policy for claims in excess of the Corporation's self-insured limits. The Corporation's independent actuary estimated the expected costs to settle such claims. Accrued losses have been discounted at 3%.

The Hospital has accrued self-insurance liabilities of \$1,090,230 and \$1,269,265 for the estimated costs of settlements for its professional liability and general liability insurance risks as of September 30, 2012 and 2011, respectively. For claims incurred after August 31, 2009, the Hospital was covered under commercial claims made policies with no deductible and coverage of \$1,000,000 per claim and an annual aggregate of \$3,000,000 for all of the entities covered under the policy.

The Hospital was also self-insured for workers compensation claims through March 16, 2009 at which time it obtained commercial insurance. The Hospital has accrued \$50,870 and \$306,547 of self-insured liabilities as of September 30, 2012 and 2011, respectively, for workers' compensation cases. The Hospital's workers' compensation policy has no deductible and policy limits of \$1,000,000 per case with no aggregate limit for claims incurred after March 16, 2009.

#### **NOTE 14 – COMMITMENTS AND CONTINGENCIES**

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 its financial position.

The Hospital also has the following environmental exposures:

The Connecticut Department of Public Health (DPH) issued an order that requires the Hospital to monitor drinking water that comes from its well field, report the results and submit plans for review and approval by DPH to upgrade the drinking water supply system to reduce the level of uranium found in the well water. The Hospital and DPH agreed on plans and specifications for the Hospital to construct improvements to the well system and report to DPH that the work has been completed. The Hospital completed the construction of the well system improvements at a cost of \$321,292 and DPH acknowledged the project completion in a letter to the hospital dated June 26, 2012.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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### NOTE 14 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Connecticut Department of Environmental Protection (DEP) issued a consent order (Sewer Order) which requires the Hospital to perform repairs or replacements to the aging wastewater treatment system at the Hospital. The Sewer Order requires a short-term and a long-term solution. The short-term work has been completed in accordance with the Sewer Order and the Hospital has been reporting to the DEP on the status of the short-term solution. Under the long-term solution, the Hospital had until March 30, 2011 to submit to the DEP for review and approval a schedule for: (i) the investigation of and remedial action alternatives to abate any pollution at the site arising from the operation of the on-site sewage treatment system or (ii) the construction of sanitary sewers to connect the Hospital to the Stafford Water Pollution Control Facility. The schedule shall provide for completion of the actions not later than December 31, 2014. The Hospital has designed and engineered a solution that is expected to be acceptable to the DEP. This solution is expected to cost less than approximately \$855,000 and to be fully operational by December 31, 2014 in accordance with the DPH directive.

The DEP filed a civil suit in 2007 in which the DEP sought civil penalties and temporary and permanent injunctions prohibiting the Hospital from violating the hazardous waste management regulations, preventing the Hospital from maintaining a discharge to the waters of the state and violating its air permit. Five of the six counts arose from allegations relating to the use of an underground storage tank for the storage of x-ray developer fixer and the release of the developer fixer from the tank. Use of that tank ended in April 2004 and the tank was removed. Part of the injunctive relief sought is an order requiring the investigation and remediation of the release of x-ray development fixer. The sixth count alleged that the Hospital violated its general air permit by submitting its annual compliance certification for 2005 ten months late. The Hospital has recorded a conditional retirement obligation related to the costs of an environmental investigation, but has not recorded a liability for any potential costs to remediate the site due to the fact that such costs, if any, cannot be reasonably estimated until the investigation is performed. The Hospital previously remediated the site when the tank was originally removed. The Hospital and the Department have come to agreement as to a stipulation for judgment resolving the case in which the Hospital agree to: (1) the payment of a civil penalty from the bankruptcy estate (thus having no effect on the Hospital); (2) submit a groundwater monitoring plan which is to determine the sufficiency of the remedial actions taken in 2007 with respect to the removal of the old x-ray developer tank; (3) undertake waste determinations as required by state and federal regulations for all waste generated at the Hospital; and (4) file all annual reports with respect to the general air permit on time in the future.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 15 – TRANSACTIONS WITH AFFILIATES

During 2012 and 2011, the Hospital billed affiliated organizations \$662,160 and \$1,131,168, respectively, for certain expenses and rental of space.

The amounts due from (to) affiliates represent receivables from and (payables) to affiliates that do not eliminate in consolidation. These balances are comprised of the following at September 30:

	2012	2011
Due to Johnson Memorial Corporation	\$ (1,779,380)	\$ (1,439,472)
Due to Home and Community Health Services, Inc.	(217,177)	(217,336)
Due from (to) Johnson Evergreen Corporation	243,340	(338,150)
Due to Johnson Health Care, Inc.	<u>(63,951)</u>	<u>(70,463)</u>
	<u>\$ (1,817,168)</u>	<u>\$ (2,065,421)</u>

During the year ended September 30, 2012, Johnson Medical Specialists, P.C. transferred net assets of \$74,638 to JPA.

The Hospital has provided guarantees of the debt of the Corporation and Evergreen which had balances of \$3,060,000 and \$14,419,102, respectively, as of September 30, 2012.

Evergreen did not comply with the debt service coverage ratio requirement for the measurement period ended September 30, 2012. The bank waived this default and indicated that the bank will not bring any legal action against Evergreen through March 31, 2013. Management is working with the bank to modify the covenant for the period ending March 31, 2013 in order to include the Hospital and the Corporation in the covenant calculation. In the event that Evergreen does not comply with this covenant for the period ending March 31, 2013, the bank will have the ability to demand repayment of the debt.

#### NOTE 16 – CONCENTRATIONS OF CREDIT RISK

The Hospital's financial instruments that are exposed to concentrations of credit risk consist primarily of cash, investments and accounts receivable.

The Hospital places its cash deposits with high credit-quality institutions, which, at times, may exceed the Federal Deposit Insurance Corporation limits of \$250,000 per bank. The Hospital has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

# JOHNSON MEMORIAL HOSPITAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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#### NOTE 17 – FUNCTIONAL EXPENSES

The Hospital provides general patient care services to residents within its geographic location. Expenses related to providing these services are as follows for the years ended September 30:

	<u>2012</u>	<u>2011</u>
Patient care services	\$ 55,272,046	\$ 55,608,741
General and administrative (including bad debt expense, depreciation and amortization, interest and operations)	<u>16,806,660</u>	<u>13,414,197</u>
	<u>\$ 72,078,706</u>	<u>\$ 69,022,938</u>

**INDEPENDENT AUDITORS' REPORT  
ON OTHER FINANCIAL INFORMATION**

Board of Directors  
**Johnson Memorial Hospital**

Our report on our audits of the basic consolidated financial statements of Johnson Memorial Hospital as of and for the years ended September 30, 2012 and 2011 appears on page 1. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The following consolidating information is presented for purposes of additional analysis and is not a required part of the basic 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 of America. In our opinion, the information is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

*Marcum LLP*

Hartford, CT  
January 8, 2013

# JOHNSON MEMORIAL HOSPITAL

## CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2012

	Hospital	JPA	Development	Elimination	Total
<b>Assets</b>					
<b>Current Assets</b>					
Cash and cash equivalents	\$ 787,925	\$ 3,825	\$ 27,577	\$ --	\$ 819,327
Patients accounts receivable, net of allowances for uncollectible accounts	8,023,775	380,008	--	--	8,403,783
Insurance and other receivables	193,008	29,521	--	--	222,529
Inventories	1,254,591	--	--	--	1,254,591
Prepaid expenses and other current assets	759,969	93,093	--	--	853,062
<b>Total Current Assets</b>	<u>11,019,268</u>	<u>506,447</u>	<u>27,577</u>	<u>--</u>	<u>11,553,292</u>
<b>Assets Whose Use is Limited</b>					
Beneficial interests in perpetual trusts	3,616,492	--	--	--	3,616,492
Restricted cash and board designated investments	363,097	--	--	--	363,097
Investments permanently restricted by donor	843,587	--	--	--	843,587
<b>Total Assets Whose Use is Limited</b>	<u>4,823,176</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>4,823,176</u>
<b>Other Assets</b>					
Property, plant and equipment, net	19,431,008	175,945	--	--	19,606,953
Investment in joint ventures	3,106,905	--	--	--	3,106,905
Due from affiliated corporations	3,858,694	--	--	(3,858,694)	--
Deferred financing costs, net	356,845	--	--	--	356,845
Other noncurrent assets	445,000	--	--	--	445,000
<b>Total Other Assets</b>	<u>27,198,452</u>	<u>175,945</u>	<u>--</u>	<u>(3,858,694)</u>	<u>23,515,703</u>
	<u>\$ 43,040,896</u>	<u>\$ 682,392</u>	<u>\$ 27,577</u>	<u>\$ (3,858,694)</u>	<u>\$ 39,892,171</u>

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATING BALANCE SHEET (CONTINUED)**

SEPTEMBER 30, 2012

	Hospital	JPA	Development	Elimination	Total
<b>Liabilities and Net Assets (Deficit)</b>					
<b>Current Liabilities</b>					
Trade accounts payable	\$ 3,182,062	\$ 218,491	\$ --	\$ --	\$ 3,400,553
Accrued payroll and related costs	2,014,282	158,629	--	--	2,172,911
Current portion of payments due under plan of reorganization	997,500	--	--	--	997,500
Revolving line of credit	3,504,213	--	--	--	3,504,213
Current portion of mortgage payable	342,500	--	--	--	342,500
Current portion of subordinated debt	100,583	--	--	--	100,583
Current portion of capital lease obligations	61,820	--	--	--	61,820
Estimated amounts due to third-party agencies	1,272,580	--	--	--	1,272,580
Other current liabilities	116,508	--	--	--	116,508
<b>Total Current Liabilities</b>	<b>11,592,048</b>	<b>377,120</b>	<b>--</b>	<b>--</b>	<b>11,969,168</b>
<b>Long-Term Obligations</b>					
Due to affiliate corporations	942,068	12,702,779	--	(11,827,679)	1,817,168
Payments due under plan of reorganization	5,505,445	--	--	--	5,505,445
Mortgage payable - less current portion	11,816,250	--	--	--	11,816,250
Subordinated debt - less current portion	231,464	--	--	--	231,464
Other long-term debt	1,300,000	--	--	--	1,300,000
Obligations under capital lease - less current portion	58,370	--	--	--	58,370
Self-insurance liabilities	1,141,100	--	--	--	1,141,100
Other liabilities	769,553	--	--	--	769,553
<b>Total Long-Term Obligations</b>	<b>21,764,250</b>	<b>12,702,779</b>	<b>--</b>	<b>(11,827,679)</b>	<b>22,639,350</b>

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATING BALANCE SHEET (CONTINUED)**

SEPTEMBER 30, 2012

	Hospital	JPA	Development	Elimination	Total
<b>Net Assets (Deficit)</b>					
Unrestricted	\$ 4,961,873	\$ (12,397,507)	\$ 27,577	\$ 7,968,985	\$ 560,928
Temporarily restricted	262,646	--	--	--	262,646
Permanently restricted	4,460,079	--	--	--	4,460,079
<b>Total Net Assets (Deficit)</b>	<u>9,684,598</u>	<u>(12,397,507)</u>	<u>27,577</u>	<u>7,968,985</u>	<u>5,283,653</u>
	<u>\$ 43,040,896</u>	<u>\$ 682,392</u>	<u>\$ 27,577</u>	<u>\$ (3,858,694)</u>	<u>\$ 39,892,171</u>

# JOHNSON MEMORIAL HOSPITAL

## CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2011

	Hospital	JPA	Development	Elimination	Total
<b>Assets</b>					
<b>Current Assets</b>					
Cash and cash equivalents	\$ 884,888	\$ 1,251	\$ 27,577	\$ --	\$ 913,716
Patients accounts receivable, net of allowances for uncollectible accounts	7,216,452	324,988	--	--	7,541,440
Insurance and other receivables	1,412,421	2,999	--	--	1,415,420
Inventories	1,216,495	--	--	--	1,216,495
Prepaid expenses and other current assets	901,401	76,300	--	--	977,701
<b>Total Current Assets</b>	<b>11,631,657</b>	<b>405,538</b>	<b>27,577</b>	<b>--</b>	<b>12,064,772</b>
<b>Assets Whose Use is Limited</b>					
Beneficial interests in perpetual trusts	3,165,722	--	--	--	3,165,722
Restricted cash and board designated investments	517,407	--	--	--	517,407
Investments permanently restricted by donor	843,587	--	--	--	843,587
<b>Total Assets Whose Use is Limited</b>	<b>4,526,716</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>4,526,716</b>
<b>Other Assets</b>					
Property, plant and equipment, net	21,293,270	196,249	--	--	21,489,519
Investment in joint ventures	2,856,651	--	--	--	2,856,651
Due from affiliated corporations	2,019,428	--	--	(2,019,428)	--
Deferred financing costs, net	540,827	--	--	--	540,827
Other noncurrent assets	445,000	--	--	--	445,000
<b>Total Other Assets</b>	<b>27,155,176</b>	<b>196,249</b>	<b>--</b>	<b>(2,019,428)</b>	<b>25,331,997</b>
	<b>\$ 43,313,549</b>	<b>\$ 601,787</b>	<b>\$ 27,577</b>	<b>\$ (2,019,428)</b>	<b>\$ 41,923,485</b>

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATING BALANCE SHEET (CONTINUED)**

SEPTEMBER 30, 2011

	Hospital	JPA	Development	Elimination	Total
<b>Liabilities and Net Assets (Deficit)</b>					
<b>Current Liabilities</b>					
Trade accounts payable	\$ 2,434,285	\$ 241,765	\$ --	\$ --	\$ 2,676,050
Accrued payroll and related costs	1,770,107	140,899	--	--	1,911,006
Current portion of payments due under plan of reorganization	1,323,916	--	--	--	1,323,916
Revolving line of credit	4,651,186	--	--	--	4,651,186
Current portion of mortgage payable	342,500	--	--	--	342,500
Current portion of subordinated debt	94,035	--	--	--	94,035
Current portion of capital lease obligations	180,261	--	--	--	180,261
Estimated amounts due to third-party agencies	1,266,304	--	--	--	1,266,304
Other current liabilities	185,834	--	--	--	185,834
<b>Total Current Liabilities</b>	<b>12,248,428</b>	<b>382,664</b>	<b>--</b>	<b>--</b>	<b>12,631,092</b>
<b>Long-Term Obligations</b>					
Due to affiliate corporations	1,392,701	10,661,133	--	(9,988,413)	2,065,421
Payments due under plan of reorganization	6,132,010	--	--	--	6,132,010
Mortgage payable - less current portion	12,158,750	--	--	--	12,158,750
Subordinated debt - less current portion	333,115	--	--	--	333,115
Obligations under capital lease - less current portion	29,810	--	--	--	29,810
Self-insurance liabilities	1,575,812	--	--	--	1,575,812
Other liabilities	752,910	--	--	--	752,910
<b>Total Long-Term Obligations</b>	<b>22,375,108</b>	<b>10,661,133</b>	<b>--</b>	<b>(9,988,413)</b>	<b>23,047,828</b>
<b>Total Liabilities</b>	<b>34,623,536</b>	<b>11,043,797</b>	<b>--</b>	<b>(9,988,413)</b>	<b>35,678,920</b>

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATING BALANCE SHEET (CONTINUED)**

SEPTEMBER 30, 2011

	Hospital	JPA	Development	Elimination	Total
<b>Net Assets (Deficit)</b>					
Unrestricted	\$ 4,359,087	\$ (10,442,010)	\$ 27,577	\$ 7,968,985	\$ 1,913,639
Temporarily restricted	321,617	--	--	--	321,617
Permanently restricted	4,009,309	--	--	--	4,009,309
<b>Total Net Assets (Deficit)</b>	<u>8,690,013</u>	<u>(10,442,010)</u>	<u>27,577</u>	<u>7,968,985</u>	<u>6,244,565</u>
	<u>\$ 43,313,549</u>	<u>\$ 601,787</u>	<u>\$ 27,577</u>	<u>\$ (2,019,428)</u>	<u>\$ 41,923,485</u>

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATING STATEMENT OF OPERATIONS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2012**

	Hospital	JPA	Development	Elimination	Total
<b>Operating Revenue</b>					
Net patient service revenues	65,318,418	4,016,223	\$ --	\$ --	\$ 69,334,641
Grant and other income	257,382	930,057	--	(878,768)	308,671
Net assets released from restriction	25,552	--	--	--	25,552
<b>Total Operating Revenues</b>	<u>65,601,352</u>	<u>4,946,280</u>	<u>--</u>	<u>(878,768)</u>	<u>69,668,864</u>
<b>Expenses</b>					
Salaries	27,169,377	3,680,362	--	583,431	31,433,170
Employee benefits	6,788,404	453,433	--	128,353	7,370,190
Provision for uncollectible accounts	3,564,251	209,203	--	--	3,773,454
Professional fees and outsourced staffing	2,874,357	555,730	--	(64,242)	3,365,845
Depreciation and amortization	3,178,071	35,471	--	--	3,213,542
Purchased services	4,029,151	1,128,581	--	(1,526,310)	3,631,422
Supplies, drugs and patient care	7,042,738	87,983	--	--	7,130,721
Leases and service contracts	1,649,063	26,374	--	--	1,675,437
Occupancy costs	2,820,491	291,194	--	--	3,111,685
Insurance	894,280	284,235	--	--	1,178,515
Other expenses	4,475,162	223,848	--	--	4,699,010
Interest	1,495,715	--	--	--	1,495,715
<b>Total Expenses</b>	<u>65,981,060</u>	<u>6,976,414</u>	<u>--</u>	<u>(878,768)</u>	<u>72,078,706</u>
<b>Loss from Operations</b>	<u>(379,708)</u>	<u>(2,030,134)</u>	<u>--</u>	<u>--</u>	<u>(2,409,842)</u>

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATING STATEMENT OF OPERATIONS (CONTINUED)**

**FOR THE YEAR ENDED SEPTEMBER 30, 2012**

	Hospital	JPA	Development	Elimination	Total
<b>Nonoperating Revenue (Loss)</b>					
Investment income	\$ 177,006	\$ --	\$ --	\$ --	\$ 177,006
Gain on sale of equipment	3,196	--	--	--	3,196
Equity earnings in joint ventures	250,254	--	--	--	250,254
	<u>430,456</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>430,456</u>
<b>Excess (Deficiency) of Revenues over Expenses</b>	<u>\$ 50,748</u>	<u>\$ (2,030,134)</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ (1,979,386)</u>

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATING STATEMENT OF OPERATIONS**

**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

	Hospital	JPA	Development	Elimination	Total
<b>Operating Revenue</b>					
Net patient service revenues	\$ 59,499,426	\$ 5,082,869	\$ --	\$ --	\$ 64,582,295
Grant and other income	589,869	912,760	--	(893,081)	609,548
Net assets released from restriction	33,994	--	--	--	33,994
<b>Total Operating Revenues</b>	<u>60,123,289</u>	<u>5,995,629</u>	<u>--</u>	<u>(893,081)</u>	<u>65,225,837</u>
<b>Expenses</b>					
Salaries	26,208,820	4,268,669	--	470,327	30,947,816
Employee benefits	6,820,412	573,409	--	101,892	7,495,713
Provision for uncollectible accounts	1,928,135	602,318	--	--	2,530,453
Professional fees and outsourced staffing	2,865,585	744,032	--	(51,744)	3,557,873
Depreciation and amortization	3,243,262	34,272	--	--	3,277,534
Purchased services	4,322,218	1,133,955	--	(1,413,556)	4,042,617
Supplies, drugs and patient care	6,946,973	89,081	--	--	7,036,054
Leases and service contracts	1,531,258	24,469	--	--	1,555,727
Occupancy costs	2,512,086	300,866	--	--	2,812,952
Insurance	866,257	448,372	--	--	1,314,629
Other expenses	2,851,463	119,413	--	--	2,970,876
Interest	1,480,694	--	--	--	1,480,694
<b>Total Expenses</b>	<u>61,577,163</u>	<u>8,338,856</u>	<u>--</u>	<u>(893,081)</u>	<u>69,022,938</u>
<b>Loss from Operations</b>	<u>(1,453,874)</u>	<u>(2,343,227)</u>	<u>--</u>	<u>--</u>	<u>(3,797,101)</u>

**JOHNSON MEMORIAL HOSPITAL**  
**CONSOLIDATING STATEMENT OF OPERATIONS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

	Hospital	JPA	Development	Elimination	Total
<b>Nonoperating Revenue</b>					
Investment income	\$ 123,908	\$ --	\$ --	\$ --	\$ 123,908
Equity loss in joint ventures	(12,760)	--	--	--	(12,760)
	<u>111,148</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>111,148</u>
<b>Loss Before Reorganization Items</b>	<u>(1,342,726)</u>	<u>(2,343,227)</u>	<u>--</u>	<u>--</u>	<u>(3,685,953)</u>
<b>Reorganization Items</b>					
Gain on discharge of debt	<u>1,094,678</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>1,094,678</u>
	<u>1,094,678</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>1,094,678</u>
<b>Excess (Deficiency) of Revenues over Expenses</b>	<u>\$ (248,048)</u>	<u>\$ (2,343,227)</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ (2,591,275)</u>