

CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Middlesex Health System, Inc. and Subsidiaries
Years Ended September 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Middlesex Health System, Inc. and Subsidiaries

Consolidated Financial Statements

Years Ended September 30, 2012 and 2011

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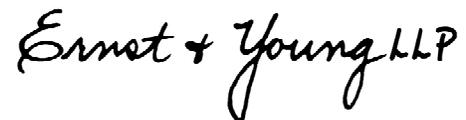
Report of Independent Auditors

The Board of Directors
Middlesex Health System, Inc.

We have audited the accompanying balance sheets of Middlesex Health System, Inc. (the System) as of September 30, 2012, and the related statements of operations, changes in net assets and cash flows for the year 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. The financial statements of the System for the year ended September 30, 2011, were audited by other auditors whose report dated January 23, 2012, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Middlesex Health System, Inc. as of September 30, 2012, and the results of its operations, changes in net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.



January 28, 2013

Middlesex Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

(in thousands)

	September 30	
	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 58,568	\$ 59,543
Short-term investments (Note 5)	10,187	10,647
Patient accounts receivable, less reserve for uncollectible amounts of approximately \$11,600 and \$12,000 in 2012 and 2011, respectively	45,951	43,838
Other receivables	3,716	2,867
Prepaid and other	3,772	3,745
Current portion of investments limited as to use (Note 5)	4,613	4,188
Total current assets	<u>126,807</u>	<u>124,828</u>
Investments limited as to use (Note 5)	119,088	102,448
Long-term investments	15,481	-
Other assets:		
Investments in joint ventures and limited partnerships (Note 1)	47	86
Other	3,978	4,944
Total other assets	<u>4,025</u>	<u>5,030</u>
Property and equipment, net (Note 6)	188,986	184,420
Total assets	<u>\$ 454,387</u>	<u>\$ 416,726</u>
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt and capital lease obligations (Note 7)	\$ 4,915	\$ 3,622
Accounts payable	19,616	19,224
Accrued payroll and related liabilities	33,912	30,639
Estimated third-party payor settlements	2,944	207
Other accrued liabilities	2,304	2,311
Current portion of estimated self-insurance liability (Note 10)	8,133	7,187
Current portion of accrued retirement liabilities (Note 8)	48	65
Total current liabilities	<u>71,872</u>	<u>63,255</u>
Other liabilities:		
Long-term debt and capital lease obligations, net of current portion (Note 7)	69,383	72,734
Estimated self-insurance liability, net of current portion (Note 10)	5,447	5,632
Accrued retirement liabilities, net of current portion (Note 8)	129,719	117,232
Estimated third party payor settlements and other	11,156	14,328
Total other liabilities	<u>215,705</u>	<u>209,926</u>
Net assets:		
Unrestricted	150,651	130,362
Temporarily restricted (Notes 11 and 12)	9,195	6,303
Permanently restricted (Notes 11 and 12)	6,964	6,880
Total net assets	<u>166,810</u>	<u>143,545</u>
Total liabilities and net assets	<u>\$ 454,387</u>	<u>\$ 416,726</u>

See accompanying notes.

Middlesex Health System, Inc. and Subsidiaries

Consolidated Statements of Operations

(In thousands)

	Years Ended September 30	
	2012	2011
Unrestricted revenues:		
Net patient service revenue (Notes 2 and 3)	\$ 361,466	\$ 349,445
Other revenue (Note 4)	12,534	9,990
Total unrestricted revenues	<u>374,000</u>	<u>359,435</u>
Operating expenses:		
Salaries and wages	171,970	165,100
Fringe benefits	39,621	44,396
Purchased services	26,479	24,165
Supplies	35,376	33,893
Depreciation and amortization	22,115	22,454
Interest	3,405	3,614
Provision for bad debts, net of recoveries	12,256	13,720
Other operating expenses	40,435	37,281
Total operating expenses	<u>351,657</u>	<u>344,623</u>
Income from operations	22,343	14,812
Other income (expense):		
Net income from joint ventures and general partnerships (Note 1)	2,224	970
Unrestricted gifts and bequests	467	471
Net investment income	2,161	4,998
Other non-operating expenses	(946)	(1,121)
Gain on sale of partnership investments	-	1,170
Loss from extinguishment of debt	-	(1,337)
Total other income, net	<u>3,906</u>	<u>5,151</u>
Excess of revenues over expenses	<u>\$ 26,249</u>	<u>\$ 19,963</u>

See accompanying notes.

Middlesex Health System, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets

(In thousands)

	Years Ended September 30	
	2012	2011
Unrestricted net assets:		
Excess of revenues over expenses	\$ 26,249	\$ 19,963
Change in net unrealized gains on other than trading securities	12,923	(5,779)
Change in accumulated pension charges to unrestricted net assets (Note 8)	(19,085)	(19,038)
Additional paid-in capital	58	-
Net assets released from restrictions for purchase of property and equipment	144	406
Change in unrestricted net assets	<u>20,289</u>	<u>(4,448)</u>
Temporarily restricted net assets:		
Contributions	3,008	1,039
Net realized investment gains	222	267
Change in net unrealized gains	1,049	(335)
Net assets released from restrictions for purchase of property and equipment	(144)	(406)
Expenditures for intended purposes	(1,243)	(1,100)
Change in temporarily restricted net assets	<u>2,892</u>	<u>(535)</u>
Permanently restricted net assets:		
Contributions	83	85
Net realized investment gains	-	(9)
Change in net unrealized gains	1	-
Change in permanently restricted net assets	<u>84</u>	<u>76</u>
Change in net assets	<u>23,265</u>	<u>(4,907)</u>
Net assets, beginning of year	<u>143,545</u>	148,452
Net assets, end of year	<u><u>\$ 166,810</u></u>	<u><u>\$ 143,545</u></u>

See accompanying notes.

Middlesex Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(In thousands)

	Years Ended September 30	
	2012	2011
Cash flows from operating activities		
Change in net assets	\$ 23,265	\$ (4,907)
Adjustments in reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	22,115	22,454
Provision for bad debts, net of recoveries	12,256	13,720
Loss from extinguishment of debt	–	1,337
Change in accumulated pension charges to unrestricted net assets	19,085	19,038
Restricted contributions, net of expenditures	(1,848)	(24)
Change in net unrealized and realized gains on investments	(16,356)	858
Change in operating assets and liabilities:		
Patient accounts receivable	(14,369)	(18,388)
Other receivables	(804)	(1,393)
Prepaid and other assets	(910)	(607)
Accounts payable, accrued payroll and related liabilities, and other liabilities	486	8,171
Accrued retirement liabilities	(6,615)	(9,617)
Estimated self-insurance liability	716	845
Estimated third-party payor settlements	2,737	541
Net cash provided by operating activities	<u>39,758</u>	<u>32,028</u>
Cash flows from investing activities		
Purchases of property and equipment	(26,800)	(38,590)
Short-term investments, net	460	16,926
Long-term investments, net	(15,481)	–
Proceeds from sales of investments limited as to use	3,569	11,532
Purchases of investments limited as to use	(6,726)	(18,141)
Distributions from joint ventures	1,888	310
Investment income	2,448	6,150
Net cash used in investing activities	<u>(40,642)</u>	<u>(21,813)</u>
Cash flows from financing activities		
Proceeds from issuance of long-term debt	3,177	39,440
Payments for refinancing of long-term debt	–	(38,659)
Repayment of long-term debt and lease obligations	(5,116)	(3,719)
Deferred financing costs	–	(631)
Restricted contributions, net of expenditures	1,848	24
Net cash used in financing activities	<u>(91)</u>	<u>(3,545)</u>
Net (decrease) increase in cash and cash equivalents	<u>(975)</u>	<u>6,670</u>
Cash and cash equivalents, beginning of year	59,543	52,873
Cash and cash equivalents, end of year	<u>\$ 58,568</u>	<u>\$ 59,543</u>
Supplemental disclosure of cash flow information		
Cash paid for interest	<u>\$ 3,327</u>	<u>\$ 3,711</u>
Cash paid for taxes	<u>\$ 100</u>	<u>\$ 895</u>

See accompanying notes.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2012 and 2011

(amounts in thousands)

1. Organization and Significant Accounting Policies

Organization

Middlesex Health System, Inc. (the Corporation) is a not-for-profit, nonstock Connecticut holding company. The Corporation is the sole member/shareholder of its wholly owned subsidiaries as follows: Middlesex Hospital (the Hospital), Middlesex Health Services, Inc. (Services), Middlesex Health Resources, Inc. (Resources), MHS Primary Care, Inc. (MHSPC), and Integrated Resources for the Middlesex Area, L.L.C. (IRMA). Middlesex Hospital is a not-for-profit acute care hospital and also has a 50% ownership in the Middlesex Center for Advanced Orthopedic Surgery, LLC. Services operates an assisted living facility. Resources owns and manages certain real estate and also owns an interest in a collection agency. MHSPC owns and operates physician practices. IRMA is inactive. In addition to serving as the sole member/shareholder of the subsidiary organizations, the Corporation directs all the fund raising activities on their behalf. The Corporation and its subsidiaries are collectively referred to as “the System.”

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Corporation and its subsidiaries (the System). All intercompany accounts and transactions have been eliminated.

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles.

Cash Equivalents and Short-Term Investments

Cash equivalents represent highly liquid investments with maturities of less than three months. Short-term investments are primarily corporate bonds and commercial paper, with maturities of three to twelve months. Both exclude amounts limited as to use by the Board of Directors (Board) designation or other restrictive arrangements.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

1. Organization and Significant Accounting Policies (continued)

Accounts Receivable and Net Patient Service Revenue

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

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

Investments and Investment Income

Investment income includes unrestricted realized gains and losses and unrestricted interest and dividends from board-designated funds and donor restricted funds included in investments limited as to use on the balance sheets. Income on short-term investment funds held by a trustee and assets deposited in the Hospital's self-insurance trust fund are reported as other revenue.

If donor restricted, the realized investment income and losses from donor restricted investments are added to the appropriate restricted net assets. Unrealized gains and losses on all investments are excluded from the excess of revenues over expenses and recorded as a component of net assets, except when certain declines represent an other-than-temporary impairment in accordance with the System's policy. Other-than-temporary impairments of \$64 and \$868 were recorded in net investment income in the statements of operations for the fiscal years ended September 30, 2012 and 2011, respectively.

Investments Limited as to Use

Investments limited as to use include assets set aside by the Board for future unspecified uses and to support education and other programs. The Board retains control over these funds and may at its discretion subsequently authorize the use of these funds for any purpose. Investments limited as to use also include donor restricted assets, assets held by trustees under revenue bond agreements, and a self-insurance trust arrangement.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

1. Organization and Significant Accounting Policies (continued)

Investments in Joint Ventures

The subsidiaries have investments in various joint ventures. These investments are accounted for using the equity method of accounting.

Resources is a partner in a joint venture to operate MedConn Collection Agency, Inc., a collection agency engaged in the collection of unpaid patient accounts due hospitals and other medical service providers.

Under the terms of the agreement, Resources' share is 20% of the net operating profits and losses of the joint venture.

Summarized unaudited financial information for the joint venture as of and for the years ended September 30 is as follows:

	<u>2012</u>	<u>2011</u>
Current assets	\$ 538	\$ 717
Noncurrent assets	689	578
Total assets	<u>\$ 1,227</u>	<u>\$ 1,295</u>
Current liabilities	\$ 129	\$ 173
Total liabilities	813	743
Total revenues	3,108	3,572
Net income	244	290

Property and Equipment, Net

Property and equipment acquisitions are recorded at cost. Property and equipment donated to the System are recorded at fair value at the date of receipt. Improvements and major renewals are capitalized, and maintenance and repairs are charged to expense as incurred.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

1. Organization and Significant Accounting Policies (continued)

Depreciation is provided over the estimated useful life of each class of asset and is computed on the straight-line method. Estimated useful lives range from 3 to 10 years for equipment and 20 to 40 years for buildings and land improvements. A leased building is amortized over the capital lease term of 25 years.

Long-Lived Assets

The System reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset exceeds its fair value and may not be recoverable. At September 30, 2012 and 2011, no impairment was recorded.

Estimated Self-Insurance Liability

The Hospital has adopted a policy of self-insuring the deductible portion of its medical malpractice and general liability insurance coverage. The deductible limits were \$1,000 per claim and \$3,000 in aggregate annually during fiscal 2012 and 2011. The System, in consultation with its actuary, records as a liability an estimate of expected losses. Such liability, discounted at 3%, totaled \$13,919 and \$13,685 at September 30, 2012 and 2011, respectively. In addition, the Hospital and Services self-insure the workers' compensation program and have purchased excess insurance for those losses exceeding \$400 per occurrence (see Note 10).

Net Asset Categories

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

Unrestricted

Unrestricted net assets represent available resources other than donor restricted contributions. Included in unrestricted net assets are assets set aside by the Board for future unspecified uses and to support education and other programs over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

1. Organization and Significant Accounting Policies (continued)

Temporarily Restricted

Temporarily restricted net assets represent contributions that are restricted by the donor either as to purpose and/or as to time of expenditure.

Permanently Restricted

Permanently restricted net assets represent contributions received with the donor stipulation that the principal be invested in perpetuity and that only the income earned thereon be available for specific or general purposes.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions, which is included in other operating revenue. Donor-restricted contributions whose restrictions are met within the same year as received are classified as unrestricted contributions in the accompanying financial statements.

Excess of Revenues Over Expenses

The statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from the excess of revenues over expenses (the performance indicator) include unrealized gains (losses) on other than trading securities, equity transfers from affiliates, both temporarily and permanently restricted donations and investment income, changes in perpetual trust arrangements and the change in pension funding and postretirement obligations.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

1. Organization and Significant Accounting Policies (continued)

Income Taxes

The Corporation, Hospital and Services are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are generally exempt from Federal income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code.

The Hospital's unrelated trade or business activities are generally limited to income from the laboratory and linen services departments. The laboratory provides services to patients referred by private physician practices and tests patient specimens submitted by skilled nursing facilities. The linen services department provides linen services to local physician offices and healthcare organizations.

Resources has no available federal net operating losses at September 30, 2012 and no available state net operating losses to offset future state taxable income.

As of September 30, 2012, MHSPC had net operating loss carryforwards available to reduce its future Federal taxable income of approximately \$24,518. The carryforward periods expire at various dates through 2031. MHSPC had net operating loss carryforwards available to reduce its future state taxable income of approximately \$13,608. The state carryforward periods expire at various dates through 2031. The deferred tax asset associated with MHSPC's loss carryforwards was offset by a corresponding valuation allowance, as realization of such loss carryforwards is not assured.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. Financial statement areas where management applies the use of assumptions and estimates consist primarily of investments, the allowance for uncollectible accounts, net patient service revenue, third-party reimbursement matters, accrued retirement liabilities, and estimated self-insurance liability.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

1. Organization and Significant Accounting Policies (continued)

Reclassifications

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

Recently Issued Authoritative Pronouncements

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

In August 2010, the FASB issued ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*. ASU 2010-24 addresses the diversity in the accounting for medical malpractice and similar liabilities and their related anticipated insurance recoveries by health care entities that mostly have netted insurance recoveries against the accrued liability, although some have presented the anticipated insurance recovery and the liability on a gross basis. The amendments to ASC 954 clarify that a health care entity should not net insurance recoveries against a related claim liability; the amount of the claim liability should be determined without consideration of insurance recoveries. The System adopted the required components of this guidance in 2012. As a result of the adoption of this standard, the System increased other current assets and self-insured liability by approximately \$170.

In July 2011, the FASB issued ASU 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts*. The guidance requires certain health care entities to present the bad debt expense associated with patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) rather than as an operating expense. The guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011, with early adoption permitted. Management is currently evaluating the impact and has not adopted this guidance for the current year.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

2. Healthcare Regulatory Environment

Federal Regulatory Environment

The healthcare industry is subject to numerous laws and regulations of Federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, Medicare and Medicaid fraud and abuse and security and privacy of health information. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Hospital and MHSPC are in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

The State of Connecticut Public Act No. 11-6, An Act Concerning the Budget for the Biennium Ending June 30, 2013 and Other Provisions Relating to Revenue, includes a tax on the net patient revenues of hospitals and changes to the Disproportionate Share Hospital (DSH) payments to hospitals effective for the State's fiscal year beginning July 1, 2011. The Hospital's combined negative impact on its income from operations for 2012 was \$1,414.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

3. Net Patient Service Revenue

The following table summarizes revenues from services to patients:

	<u>2012</u>	<u>2011</u>
Gross patient service revenue	<u>\$ 1,140,027</u>	<u>\$ 1,053,422</u>
Deductions:		
Allowances	(771,052)	(697,121)
Charity care	(7,509)	(6,856)
	<u>(778,561)</u>	<u>(703,977)</u>
Net patient service revenue	<u>\$ 361,466</u>	<u>\$ 349,445</u>

The Hospital and MHSPC have agreements with third-party payors that provide reimbursement at amounts different from established billing rates. These differences, including self-insured portion of health care benefits provided at its facilities for its employees and their dependents, are accounted for as allowances in determining net patient service revenue.

The Hospital has a longstanding commitment to providing healthcare to all those in need, regardless of their ability to pay. The Hospital provides both free care and care at reduced rates. The costs for providing these services were calculated using an adjusted cost-to-charge ratio. The charges written off for patients that qualified for free care under the Hospital's Charity Care Program totaled approximately \$7,509 and \$6,856 in 2012 and 2011, respectively. The estimated costs for these services were \$2,081 and \$2,042 in 2012 and 2011, respectively.

During 2012 and 2011 approximately 34% of net patient service revenue was received under the Medicare program, 9% under the state Medicaid and city welfare programs, 48% was received from contracts with private health payors and 9% from patients and others. During the years ended September 30, 2012 and 2011, changes in estimates related to settlements with third-party payors for prior years (decreased) increased net patient service revenue by \$(1,444) and \$481, respectively.

As of September 30, 2012 and 2011, approximately 36% and 33%, respectively, of patient accounts receivable was due from Medicare, 8% and 10%, respectively, was due from Medicaid and city welfare, 37% was due from private health payors and 19% and 20%, respectively, was due from patients and others.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

4. Other Revenue

Certain health care providers can earn incentive payments between 2011 and 2016 from Medicare and Medicaid for establishing an Electronic Health Record (EHR) system and maintaining its meaningful use. The Hospital recognizes income when it is reasonably assured that it is in compliance with the program criteria. The Hospital has included amounts in other operating revenue related to the program for fiscal year 2012.

Other revenue consists of the following for fiscal years:

	2012	2011
EHR income	\$ 2,838	\$ —
Grants	2,011	1,908
Cafeteria sales	1,264	1,267
Technical laboratory income	1,164	1,035
Investment income	625	965
Rental income	628	761
Purchase discounts	363	393
Miscellaneous	3,641	3,661
	\$ 12,534	\$ 9,990

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

5. Investments Limited as to Use and Investments

Cost and market values for investments included in investments limited as to use as of September 30 are summarized as follows:

	2012		2011	
	Market	Cost	Market	Cost
Mutual funds				
Equity	\$ 71,289	\$ 59,469	\$ 47,388	\$ 47,854
Fixed income	38,780	35,464	42,411	40,336
Common stock				
U.S. equity	4,672	3,039	3,586	3,017
Non-U.S. equity	720	463	597	602
Corporate debt securities	13,728	13,740	6,823	6,886
U.S. Government and Agency obligations	12,868	12,863	4,973	4,981
Money market funds	5,346	5,345	6,140	6,173
Cash	1,966	1,966	5,365	5,365
Total	\$ 149,369	\$ 132,349	\$ 117,283	\$ 115,214

At September 30, 2012, investments with a fair value below cost for more than 12 months included certain common stock with a fair value of \$55 and an unrealized loss of \$(65).

At September 30, 2011, investments with a fair value below cost for less than 12 months included certain common stock and U.S. Government and Agency obligations with a fair value of \$454 and \$236, respectively, and an unrealized loss of \$31 and \$1, respectively. Investments with fair value below cost for more than 12 months included certain mutual funds, common stock and U.S. Government and Agency obligations with a fair value of \$15,708, \$792, and \$685, respectively, and an unrealized loss of \$1,450, \$81 and \$1, respectively.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

5. Investments Limited as to Use and Investments (continued)

Investments limited as to use consisted of the following as of September 30:

	2012		2011	
	Market	Cost	Market	Cost
Funds held in trust under revenue bond agreements	\$ 4,407	\$ 4,405	\$ 4,537	\$ 4,539
Funds held in trust for estimated self-insurance liability	8,413	7,705	7,771	7,564
Board-designated funds	95,568	81,484	80,737	79,087
Donor-restricted funds	15,313	13,078	13,591	13,307
Total	\$ 123,701	\$ 106,672	\$ 106,636	\$ 104,497

Included in net investment income for the years ended September 30, 2012 and 2011 were realized (losses) gains on sales of investments of \$(606) and \$3,500, respectively.

Investments are reported at fair value based on readily determinable fair market values or estimated fair value. Donated investments are reported at fair value at the date of receipt, which is then treated as cost.

FASB Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, establishes a formal hierarchy and framework for measuring fair value, and expanded disclosure about fair value measurements and the reliability of valuation inputs. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

- **Level 1** – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the System has the ability to access.
- **Level 2** – Inputs to the valuation methodology include:
 - Quoted prices for similar assets or liabilities in active markets;

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

5. Investments Limited as to Use and Investments (continued)

- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

- **Level 3** – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Investment securities, in general, are exposed to various risks. Recent market conditions have resulted in an unusually high degree of volatility and increased the risks and short term liquidity of certain investments held by the System which could impact the value of investments after the date of these consolidated financial statements.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

5. Investments Limited as to Use and Investments (continued)

The following table sets forth by level, within the fair value hierarchy, the System's assets at fair value as of September 30, 2012:

	Fair Value as Determined by Quoted Prices in Active Markets (Level 1)	Valuation Techniques Based on Observable Market Data (Level 2)	Valuation Techniques Incorporating Information Other Than Observable Market Data (Level 3)	Total
Mutual funds				
Equity	\$ 71,289	\$ —	\$ —	\$ 71,289
Fixed income	—	38,780	—	38,780
Common stock				
U.S. equity	4,672	—	—	4,672
Non-U.S. equity	720	—	—	720
Corporate debt securities	—	13,727	—	13,727
U.S. Government and Agency obligations	—	12,868	—	12,868
Money market funds	5,346	—	—	5,346
Cash and cash equivalents	60,535	—	—	60,535
	<u>\$ 142,562</u>	<u>\$ 65,375</u>	<u>\$ —</u>	<u>\$ 207,937</u>

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

5. Investments Limited as to Use and Investments (continued)

The following table sets forth by level, within the fair value hierarchy, the System's assets at fair value as of September 30, 2011:

	Fair Value as Determined by Quoted Prices in Active Markets (Level 1)	Valuation Techniques Based on Observable Market Data (Level 2)	Valuation Techniques Incorporating Information Other Than Observable Market Data (Level 3)	Total
Mutual funds				
Equity	\$ 47,388	\$ –	\$ –	\$ 47,388
Fixed income	–	42,411	–	42,411
Common stock				
U.S. equity	3,586	–	–	3,586
Non-U.S. equity	597	–	–	597
Corporate debt securities	–	6,823	–	6,823
U.S. Government and Agency obligations	–	4,973	–	4,973
Money market funds	6,140	–	–	6,140
Cash and cash equivalents	61,824	–	–	61,824
	<u>\$ 119,535</u>	<u>\$ 54,207</u>	<u>\$ –</u>	<u>\$ 173,742</u>

Mutual funds and common stock are traded actively on exchanges and price quotes for these shares are readily available.

For corporate debt securities and U.S. government and agency obligations multiple prices and price types are obtained from pricing vendors whenever possible, which enables cross-provider validations. A primary price source is identified based on asset type, class or issue for each security. The fair values of fixed-income securities are based on evaluated prices that reflect observable market information, such as actual trade information of similar securities, adjusted for observable differences.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

5. Investments Limited as to Use and Investments (continued)

Net asset value (NAV) is used as a practical expedient to estimate the fair value of certain investments, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of September 30, 2012 and 2011, the System had no intentions to sell investments at amounts different than NAV.

6. Property and Equipment, Net

Property and equipment and the related accumulated depreciation as of September 30 consist of the following:

	<u>2012</u>	<u>2011</u>
Land and land improvements	\$ 13,103	\$ 10,327
Buildings and fixed equipment	233,152	247,194
Other equipment	138,415	165,051
Leasehold improvements	5,427	5,898
	<u>390,097</u>	428,470
Less accumulated depreciation	<u>(215,805)</u>	<u>(265,372)</u>
	174,292	163,098
Construction in progress (estimated cost to complete \$8,703)	14,694	21,322
Property and equipment, net	<u>\$ 188,986</u>	<u>\$ 184,420</u>

In 2012, in an effort to bring the Hospital's plant assets up to date, approximately \$72,000 of assets were retired. These assets were fully depreciated and no longer in use at the time of their retirement.

Total rental expense under operating leases for the years ended September 30, 2012 and 2011 was approximately \$5,512 and \$5,593, respectively.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

6. Property and Equipment, Net (continued)

The following is a schedule of future minimum rentals under operating lease agreements:

Fiscal year ending:	
2013	\$ 4,742
2014	4,046
2015	2,900
2016	2,091
2017	1,850
Thereafter	6,376
	<u>\$ 22,005</u>

7. Long-Term Debt

As of September 30, 2012 and 2011, the System's long-term debt consisted primarily of the following State of Connecticut Health and Educational Facilities Authority (CHEFA) Revenue Bonds and certain mortgage notes payable which are secured by certain real estate and other real property:

	<u>2012</u>	<u>2011</u>
Fixed Rate Revenue Bonds, Series N, due July 1, 2027	\$ 35,180	\$ 37,360
Fixed Rate Revenue Bonds, Series M, due July 1, 2027	12,850	13,530
Fixed Rate Revenue Bonds, Series L, due July 1, 2036	20,995	21,465
Mortgage notes and capital leases, net of interest	2,610	1,218
	<u>71,635</u>	<u>73,573</u>
Add bond premium	2,663	2,783
Less current portion	(4,915)	(3,622)
	<u>\$ 69,383</u>	<u>\$ 72,734</u>

CHEFA Series L Revenue Bonds (Series L bonds) and CHEFA Series M Auction Rate Bonds (Series M bonds) were issued on December 7, 2006 for \$22,760 and \$16,620, respectively. The Series L proceeds were used to finance the construction of a new emergency department facility and the Series M proceeds were used to refinance the Series K bonds. The Series L bonds mature from July 1, 2009 through July 1, 2036 at interest rates between 4.0% and 5.0%. On April 17,

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

7. Long-Term Debt (continued)

2008, the Series M bonds were converted from their initial auction rate mode to a fixed rate mode. The Series M bonds mature from July 1, 2008 through July 1, 2027 at interest rates between 3.0% and 4.9%. CHEFA Series N Revenue Bonds (Series N bonds) were issued on July 26, 2011 for \$31,930. The Series N proceeds were used to refinance the Series H bonds. The Series N bonds mature from July 1, 2012 through July 1, 2027 at interest rates between 3.0% and 5.0%.

The Hospital has entered into a formal unsecured revolving line of credit agreement with a local bank. The maximum borrowing limit on this line of credit totaled \$6,000 as of September 30, 2012 and 2011. Advances under this agreement have an annual interest rate based on the LIBOR rate plus 1.0% as determined for each interest period. The line of credit expires on April 30, 2012. As of September 30, 2012 and 2011 there were no advances.

In fiscal 2011, CHEFA Series N Revenue Bonds (Series N bonds) were issued on behalf of Services to refinance the Series I bonds. The Series N bonds mature from July 1, 2012 through July 1, 2027 at interest rates between 3.0% and 5.0%. As a member of the obligated group, the Hospital is a guarantor of the Series N bonds. The outstanding balance of these bonds was \$5,160 at September 30, 2012.

The Hospital and Services are required to maintain certain deposits with a trustee relating to its outstanding CHEFA bonds. Such deposits are included in investments limited as to use in the financial statements and consist of \$4,407 in debt service funds. All of the outstanding CHEFA bonds and mortgage notes place limits on the incurrence of additional borrowings and require that the Hospital satisfy certain measures of financial performance as long as the bonds and mortgage notes are outstanding. All of the outstanding CHEFA bonds are secured by the gross receipts of the Hospital.

The unamortized amount of deferred bond issuance costs was \$1,917 and \$1,994 at September 30, 2012 and 2011, respectively. Bond issuance costs are amortized over the life of the bonds using a method which does not differ materially from the effective interest method in the amount sufficient to amortize the costs over the term of the bonds.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

7. Long-Term Debt (continued)

The fair value of the Hospital's CHEFA bonds, based on market prices, was approximately \$69,258 and \$70,215 at September 30, 2012 and 2011, respectively. The fair value of Services' CHEFA bonds, based on market prices, was approximately \$5,623 and \$5,777 at September 30, 2012 and 2011, respectively.

In 2010, MHSPC entered into a 15-year capital lease in the amount of \$835 with an interest rate of 6.5% for a building. The outstanding balance on this capital lease at September 30, 2012 and 2011 was \$770 and \$807, respectively.

Aggregate scheduled repayments on long-term debt and capital lease payments are as follows:

	Long-Term Debt	Mortgage Notes/Capital Leases
2013	\$ 3,300	\$ 1,705
2014	3,400	137
2015	3,530	131
2016	3,695	115
2017	3,860	110
Thereafter	51,240	827
	<hr/> 69,025	<hr/> 3,025
Add bond premium	2,663	-
Less interest	-	(415)
	<hr/> <hr/> \$ 71,688	<hr/> <hr/> \$ 2,610

8. Defined Benefit Retirement Plans

The Hospital sponsors several retirement plans including a noncontributory, defined benefit pension plan (the Plan) covering substantially all of its employees. The Plan's benefits are based on years of credited service and average base pay during the employees' five highest-paid consecutive calendar years of credited service. The Plan is funded in accordance with the Employee Retirement Income Security Act (ERISA) minimum funding requirements.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

8. Defined Benefit Retirement Plans (continued)

On July 31, 2009 the Hospital adopted a soft freeze of the Plan, effective January 1, 2010. All pension accruals have ceased under the terms of the Plan, with the limited exception that participants who were actively employed on December 31, 2009 will continue to have eligible compensation earned after December 31, 2009 recognized in the calculation of their accrued benefit beyond December 31, 2009.

As of December 31, 2010, the current Supplemental Executive Retirement Plan (SERP) was frozen and converted from a defined benefit to a defined contribution approach. In doing so, the lump sum value of the current SERP accrued benefit as of December 31, 2010 was established as the opening defined contribution account value as of January 1, 2011. These plan changes triggered curtailment and settlement accounting in fiscal 2011 following board approval of the plan changes. For accounting purposes, the defined benefit element of the current SERP is now terminated. Beginning January 1, 2011, the defined contribution element of the current SERP (including the opening value) will be accounted for as a defined contribution plan.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

8. Defined Benefit Retirement Plans (continued)

The funded status at September 30 for the plans are as follows:

	<u>2012</u>	<u>2011</u>
Accumulated benefit obligation	<u>\$ 252,066</u>	<u>\$ 216,037</u>
Change in projected benefit obligation:		
Projected benefit obligation, beginning of year	\$ 260,453	\$ 248,047
Service cost	-	42
Interest cost	11,994	12,319
Actuarial loss	35,601	12,393
Benefits paid	(6,505)	(12,062)
Curtailments	-	(1,191)
Settlements	-	905
Projected benefit obligation, end of year	<u>301,543</u>	<u>260,453</u>
Change in plan assets:		
Fair value of plan assets, beginning of year	145,231	140,171
Actual return on plan assets	25,729	144
Employer contributions	9,963	16,978
Benefits paid	(6,505)	(12,062)
Fair value of plan assets, end of year	<u>174,418</u>	<u>145,231</u>
Funded status	<u>\$ (127,125)</u>	<u>\$ (115,222)</u>
Amounts recognized in balance sheets consist of:		
Current liability	\$ (48)	\$ (65)
Noncurrent liability	(127,077)	(115,157)
Net amount recognized	<u>\$ (127,125)</u>	<u>\$ (115,222)</u>
Amounts recognized as accumulated charges to unrestricted net assets consist of:		
Net actuarial loss	\$ 126,377	\$ 107,292
	<u>\$ 126,377</u>	<u>\$ 107,292</u>

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

8. Defined Benefit Retirement Plans (continued)

	2012	2011
Components of net periodic benefit cost:		
Service cost	\$ —	\$ 42
Interest cost	11,994	12,319
Expected return on plan assets	(11,408)	(10,917)
Net amortization and deferral	2,195	1,561
Curtailement loss	—	458
Settlement loss	—	1,823
Net periodic benefit cost	\$ 2,781	\$ 5,286

The prior service cost that will be amortized from accumulated charges to unrestricted net assets into net periodic benefit cost over the next fiscal year is \$3,501.

	2012	2011
Weighted average assumptions as of September 30:		
Discount rate (obligation)	3.90%	4.65%
Discount rate (service cost – see below)	4.65%	5.20%
Expected long-term return on plan assets	7.00%	7.00%
Rate of compensation increase	3.50%	4.00%

The discount rate is based on high-grade bond yield curve under which benefits were projected and discounted at spot rates along the curve. The discount rate was then determined as a single rate yielding the same present value.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

8. Defined Benefit Retirement Plans (continued)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of September 30, 2012:

	Fair Value as Determined by Quoted Prices in Active Markets (Level 1)	Valuation Techniques Based on Observable Market Data (Level 2)	Valuation Techniques Incorporating Information Other Than Observable Market Data (Level 3)	Total
Mutual funds				
Equity	\$ 96,936	\$ —	\$ —	\$ 96,936
Fixed income	—	58,545	—	58,545
Common/collective trust	—	10,170	—	10,170
Common stock				
U.S. equity	6,306	—	—	6,306
Non-U.S. equity	1,205	—	—	1,205
Money market funds	1,256	—	—	1,256
	<u>\$ 105,703</u>	<u>\$ 68,715</u>	<u>\$ —</u>	<u>\$ 174,418</u>

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of September 30, 2011:

	Fair Value as Determined by Quoted Prices in Active Markets (Level 1)	Valuation Techniques Based on Observable Market Data (Level 2)	Valuation Techniques Incorporating Information Other Than Observable Market Data (Level 3)	Total
Mutual funds				
Equity	\$ 72,412	\$ —	\$ —	\$ 72,412
Fixed income	—	50,568	—	50,568
Common/collective trust	—	9,504	—	9,504
Common stock				
U.S. equity	4,543	—	—	4,543
Non-U.S. equity	1,004	—	—	1,004
Money market funds	7,200	—	—	7,200
	<u>\$ 85,159</u>	<u>\$ 60,072</u>	<u>\$ —</u>	<u>\$ 145,231</u>

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

8. Defined Benefit Retirement Plans (continued)

Mutual funds and common stock are traded actively on exchanges and price quotes for these shares are readily available.

For corporate debt securities and U.S. government and agency obligations multiple prices and price types are obtained from pricing vendors whenever possible, which enables cross-provider validations. A primary price source is identified based on asset type, class or issue for each security. The fair values of fixed-income securities are based on evaluated prices that reflect observable market information, such as actual trade information of similar securities, adjusted for observable differences.

Common collective trusts invest in other public or private individual assets as determined and managed by the fund. The Plan's interest in the common/collective trust fund is based on the fair values of the underlying investments. Investments in collective trust funds are valued at their respective NAV per share/unit on the valuation date. The Plan can redeem these investments at NAV on a daily basis.

The Plan's weighted average asset allocations at September 30, 2012 and 2011 by asset category are as follows:

	Target	2012	2011
Equity securities	57%	56%	60%
Debt securities	38%	39%	40%
Balanced funds	5%	5%	—%
Total	100%	100%	100%

The investment policy, as established by the Investment Committee, is to equal or exceed the rate of return of a benchmark composed 60% of a set of stock indexes, 35% of a custom bond index and 5% of the Salomon Smith Barney World Government Bond Index. For performance evaluation purposes, all rates of return will be examined on a net-of-fee basis. The pension assets are to be broadly diversified so as to limit the impact of large losses in individual investments on the total portfolio. The asset allocation is reviewed on a quarterly basis.

Contributions of \$10,800 are expected to be paid to the Plan in 2013.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

8. Defined Benefit Retirement Plans (continued)

The following benefit payments, which reflect expected future service for the retirement plans, are expected to be paid:

2013	\$	7,725
2014		8,427
2015		9,108
2016		9,869
2017		10,751
2018 – 2022		<u>66,238</u>
	\$	<u>112,118</u>

The System does not provide post-retirement medical or health insurance benefits.

9. Defined Contribution Plans

Effective January 1, 2010 the Hospital implemented a new retirement program called the Middlesex Retirement Savings and Investment Plan which provides an automatic core contribution and a matching contribution when participants choose to make pre-tax contributions. The Hospital matches 50% of the first 4% that an employee contributes. In addition, employees become eligible for a core contribution upon completion of 12 months service provided they earn at least 1,000 hours of service in a calendar year and are actively employed on December 31, unless they retire or become disabled. The core contribution, which ranges from 2-6% of eligible pay, is based on the employee's age and years of service on December 31. The Hospital's contributions to the plan totaled \$2,795 and \$2,717 in 2012 and 2011, respectively. In addition, a core contribution of \$4,322, which is scheduled to be paid in 2013, is included in accrued payroll and related liabilities.

In addition, the Hospital sponsors other defined contribution and deferred compensation plans for eligible employees. The Hospital's contributions to these plans totaled approximately \$706 and \$1,603 in 2012 and 2011, respectively.

Services sponsors a 403(b) retirement savings plan (the Savings Plan) for its employees. The Savings Plan allows participants to contribute up to 10% of their annual compensation, not to exceed certain limitations. There is no matching contribution from Services.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

9. Defined Contribution Plans (continued)

MHSPC sponsors a defined contribution profit sharing plan (the Plan) for its eligible employees. Participants may elect to defer amounts as allowed under the Plan and Internal Revenue Code. The employer match equals 100% of the first 3% of participant elective deferrals plus 50% of the next 2% of participant elective deferrals. In addition, MHSPC may make discretionary contributions as determined by the board of directors of MHSPC. For the years ended September 30, 2012 and 2011, MHSPC made matching contributions in the amount of \$273 and \$283, respectively.

10. Estimated Self-Insurance Liability and Other Contingencies

There have been malpractice, general liability, and workers' compensation claims that fall within the Hospital's partially self-insured program (see Note 1) which have been asserted against the Hospital. In addition, there are known incidents that have occurred through September 30, 2012 that may result in the assertion of claims.

The Hospital has established an irrevocable trust, funded based upon actuarially determined funding levels, to provide for the payment of malpractice and general liability claims and related expenses.

In addition, the System is involved in litigation arising in the ordinary course of business. In the opinion of System management, the ultimate resolution of these claims will not have a material impact on the System's results of operations or financial position.

11. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the System has been limited by the donors for a specific purpose. Temporarily restricted net assets are available for the following purposes as of September 30:

	<u>2012</u>	<u>2011</u>
Education	\$ 1,993	\$ 1,750
Health services	1,489	1,397
Capital and other	5,713	3,156
	<u>\$ 9,195</u>	<u>\$ 6,303</u>

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

11. Temporarily and Permanently Restricted Net Assets (continued)

Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity. Permanently restricted net assets as of September 30 are as follows:

	<u>2012</u>	<u>2011</u>
Free beds	\$ 1,563	\$ 1,562
Support of hospital operations	4,705	4,620
Other	696	698
	<u>\$ 6,964</u>	<u>\$ 6,880</u>

12. Endowments

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

The System's endowments consist of approximately thirteen individual funds established for a variety of purposes including both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

12. Endowments (continued)

Endowment funds consist of the following at September 30, 2012:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 3,482	\$ 6,964	\$ 10,446
Board-designated endowment funds	91,908	-	-	91,908
Total endowed net assets	\$ 91,908	\$ 3,482	\$ 6,964	\$ 102,354

Endowment funds consist of the following at September 30, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 3,092	\$ 6,880	\$ 9,972
Board-designated endowment funds	77,417	-	-	77,417
Total endowed net assets	\$ 77,417	\$ 3,092	\$ 6,880	\$ 87,389

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

12. Endowments (continued)

Changes in endowment funds for the year ended September 30, 2012 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, October 1, 2011	\$ 77,417	\$ 3,092	\$ 6,880	\$ 87,389
Investment return:				
Investment income	2,160	49	–	2,209
Net appreciation	12,423	296	1	12,720
Total investment return	14,583	345	1	14,929
Contributions, gifts and bequests	–	–	83	83
Transfers	–	71	–	71
Appropriation of endowment assets for expenditure	(92)	(26)	–	(118)
Endowment net assets, September 30, 2012	\$ 91,908	\$ 3,482	\$ 6,964	\$ 102,354

Changes in endowment funds for the year ended September 30, 2011 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, October 1, 2010	\$ 77,811	\$ 3,133	\$ 6,804	\$ 87,748
Investment return:				
Investment income	4,986	111	–	5,097
Net depreciation	(5,342)	(100)	(9)	(5,451)
Total investment return	(356)	11	(9)	(354)
Contributions, gifts and bequests	–	–	85	85
Transfers	–	(32)	–	(32)
Appropriation of endowment assets for expenditure	(38)	(20)	–	(58)
Endowment net assets, September 30, 2011	\$ 77,417	\$ 3,092	\$ 6,880	\$ 87,389

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

12. Endowments (continued)

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the System must hold in perpetuity or for a donor-specified period as well as board-designated funds.

To satisfy its long term rate-of-return objectives, the System 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 System targets a diversified asset allocation that places emphasis on investments in equities, fixed income and alternative investments to achieve its long-term return objectives with prudent risk constraints.

The System follows a policy of spending an amount that approximates the investment income earned, in addition to specific purchases of capital equipment. Accordingly, the System expects its spending policy will allow its endowment funds to be maintained in perpetuity by growing at a rate at least equal to the planned payouts. Additional real endowment growth will be provided through new gifts and any excess investment return.

13. Functional Expenses

The Hospital provides health care services primarily to residents within its geographic location. Expenses to provide these services for the years ended September 30 are as follows:

	<u>2012</u>	<u>2011</u>
Health care services	\$ 284,181	\$ 282,285
Administrative and general	50,356	46,231
	<u>\$ 334,537</u>	<u>\$ 328,516</u>

14. Subsequent Events

The System has evaluated events through January 28, 2013, which represents the date the financial statements were available to be issued and noted no subsequent events that would have impacted the System's consolidated financial statements.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited)

(statistical information in whole numbers)

As a medium-sized community hospital within a health system, providing extensive Community Benefit programs and services has always been the cornerstone of our organization. Continuous dedication to the communities we serve remains the hallmark of our vision, mission, and strategic planning. These objectives are inherent in the Health System and Hospital's vision and mission statements. The System's mission is to *improve the health and well-being of our community by providing quality health care services with caring, compassion and skill* with a vision designed to *create a new standard for community health care* by contributing *materially to the health and well being of the communities it serves*. The pledge to Community Benefit is strengthened by the Hospital's inclusion of the term *Community Benefit* in its mission statement: *the Hospital recognizes community benefit, transparency and integrity as fundamental responsibilities and strives to meet community health needs to the fullest extent possible within its ability and resources*. Middlesex Hospital's Community Benefit program was formalized in 2006 as a natural outgrowth for housing our long-standing community services under one roof. Since then, strengthening our Community Benefit program with targeted programs to meet community health and well-being needs and promoting community-wide health improvement services has been an annual priority initiative for our Hospital's leadership and remains a core institutional program. Our comprehensive Community Benefit model encompasses the following domains: executive involvement and commitment; a defined reporting structure; dedicated staffing resources; governance engagement; staff participation; annual goals; inclusion in annual organizational planning; internal and external communications; and inclusion of community members and agency partners. This footnote provides an overview of Middlesex Hospital's community benefit activities, organized by the categorical accounting standards as determined by the Catholic Health Association/VHA structure (*Catholic Health Association, "A Guide For Planning and Reporting Community Benefit", 2006, revised 2008*).

Community Health Improvement Services

The Hospital subsidizes a vast range of community health education and health improvement programs, none of which are developed for marketing purposes, all of which are supported as a means of fulfilling the Hospital's mission to serve its community. Almost 100% of the time these services are offered free of charge; in the rare instance where a nominal fee is assessed, the cost of providing the service is not covered. Community health education is provided to the

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

community at large, including (but not limited to) local schools, colleges, assisted living and skilled nursing facilities, small businesses and chamber of commerce, local health care provider agencies, non-Hospital affiliated healthcare providers, and social services. Some of the programs represent one time events, however most are ongoing and over the years have become entrenched in the community as a source of support and continued education for a healthful future. Community health education is provided by the Hospital in many formats including lectures, written materials, interactive presentations and other group programs/activities. Examples of health educational programming include (but are not limited to):

- Community Education Presentations: including hand washing; H1N1 virus containment and vaccination; cancer prevention, integrative medicine, caregiver resources, chronic pulmonary obstructive disease/respiratory care, arthritis, diabetes, asthma (adult and pediatric), chronic heart failure, childhood obesity, smoking cessation, nutrition, stroke education, fall prevention. With geriatric services uncovered as a priority area in the Hospital's health assessment, the increased focus on health education for the elderly and local non-Hospital affiliated healthcare practitioners in geriatric services is exemplified by the Hospital's conducting targeted presentations to both sectors including the topics of fall prevention; the signs and symptoms of stroke; warning signs the elderly should not ignore; and 10 common healthcare errors seniors make.
- Health and Wellness Events/Health Fairs: it is common practice for the Hospital's staff members to answer the call of the community any time a request is made for educational support – one example is the annual request by Connecticut Valley Hospital, the state's department of mental health and addiction services, for the Hospital to participate in its employee and patient day-long health fair - the Hospital provides staffing to share information on multiple health topics to 400+ attendees, which includes a vulnerable general patient population as well as those held in the forensic division. The Hospital regularly participates in area health fairs/wellness events to share critical health information on topics and services including: diabetes; asthma; chronic obstructive pulmonary disease; slips and fall prevention and safety; blood pressure screenings; cancer awareness including breast, prostate and skin; smoking cessation data and information; bone density screening; maternal child health education; rehabilitation therapy; and youth behavioral health issues.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

- Support Groups: The Hospital provides, at no charge, many support groups for patients and their families in response to the community's need for additional support in addressing the social, psychological or emotional issues that often occur in connection with disease, disability and grief. The support and skills of trained professionals offer self-help techniques and wellness/health-promotion. Support groups include: bereavement; caregivers; diabetes; meditation; prostate cancer; leukemia, lymphoma, and multiple myeloma; cancer's survivors; breastfeeding; first foods; and fit for kids.
- Cancer Center Health Awareness: as facing cancer can be one of life's most challenging experiences for patients, the Hospital's Cancer Center provides extensive free-of-charge services in an educational and supportive environment. An emphasis is placed on including family members in all support services. In addition to the substantial number of cancer-related support groups, the Cancer Center offers – at no cost – an annual Breast Cancer Awareness event; annual Cancer Survivor's Day; annual prostate event; annual Healthy Living Through Prevention wellness event; an art therapy program; movement through dance; nutrition and exercise class for breast cancer patients; wig room; and a comprehensive educational series with a multi-dimensional approach to defining cancer – including dealing with side effects, the importance of nutrition and exercise, coping with emotions and spirituality, alternative and integrative medicine therapies, and methods for communication.
- Maternal Child Support: To reach out to the community's vulnerable population, the Hospital's Pregnancy and Birth Center (PBC) waives all fees for participants from the Hospital's Family Advocacy Maternal Child Health Program – a comprehensive service within the Behavioral Health Department that outreaches to low-income families lacking necessary resources. Tuition waiver allows access for Family Advocacy members to PBC's Newborn & Infant classes, Breastfeeding classes, and Prepared Childbirth classes.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

- Health Literature: providing no-cost access to health care literature and resources to the public is possible through the Hospital's libraries and publications. The Hospital's main campus and Cancer Center libraries encourage community use of health and medicine resource information. The community, including students, patients, non-employed nurses and physicians routinely utilizes the library's extensive collection of books and periodicals and depends on librarian support as a part of information gathering. The Cancer Center library is an active participant of the CT Library On Request System, which is available in public libraries as a resource to locate and borrow books, videos and tapes – with the assistance of the Hospital's librarian, patients and families are able to obtain desired cancer health information by use of this service. In addition, the Cancer Center issues a quarterly newsletter (2,500 household mailing) that reviews cancer-related and health living topics.

Throughout the year the Hospital provides a number of community-based clinical services, including clinics and screenings offered on a reoccurring basis or as a special event. The Hospital views screenings and clinics as valuable secondary prevention measures that enable the detection of early illness/disease onset, bring awareness to the screened individual regarding the importance of detection and early treatment intervention, and provide referral when appropriate and necessary. These services are offered to meet identified community needs and/or improve community health. Examples of the Hospital's community based clinical services offered to the community at large throughout the year include (but are not limited to): diabetes care free A1C screenings; annual flu shots and free blood pressure and cholesterol clinics provided by the Hospital's Homecare department, a subsidized service, to local seniors; free flu immunizations and TB testing offered to those who are unable to pay; and community-wide free screenings for blood pressure.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

Healthcare support services include all programs offered by the Hospital in order to increase access and quality of care to individuals, especially those living in poverty and/or other vulnerable populations. As these services represent targeted programs and interventions based on need, they are critical for assisting patients in achieving improved health and wellness. Given the intensity and duration of the initiatives, life-long positive impacts are often realized. Examples include (but are not limited to):

- Center for Chronic Care Management (CCCM) Disease Management: Currently over 10 years of age, a combined 10,000+ patients have been served by CCCM's various programs. The impetus for the center was an identified sub-set of repeat users of emergency department and inpatient services for asthma. A multidisciplinary team was tasked with examining notable resource gaps for this ambulatory care sensitive condition (that is, one that should be treated in the outpatient setting). A deficit of available outpatient services and coordination of care for asthmatics resulting in barriers for achievement of self-management was identified and in response, using the Chronic Care Model, an evidence-based, patient-centered outpatient asthma service for adults (AIRMiddlesex) and children (LittleAIR) was designed and implemented, offering a comprehensive and systematic approach to the management of asthma as a chronic illness. The asthma care program became the prototype for identifying and meeting community need for chronic care interventions by adding accessible and oftentimes free-of-charge outpatient services. Added services include diabetes disease management (provided since mid-1990, formalized in 2001) and its component medical nutrition therapy; smoking cessation (1999); chronic heart failure (2005); and childhood weight management (2008). The Center's disease management programs have evolved as a critical part of the health delivery system in Middlesex County by filling unmet chronic care needs. Within the CCCM model, special attention is paid to those unable to access services elsewhere: patients who experience multiple social issues, are often uninsured, are unable to achieve and sustain improved health, and frequently encounter barriers to care. Most programs are offered at no cost to the patient and the program is therefore heavily underwritten by the Hospital. Each of CCCM's initiatives cooperate with community agencies to provide chronic disease management education.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

- Cancer Care Management: the Cancer Care Program is a free program offered to patients with a breast, colon, lung, prostate or other cancer diagnosis. With compassion, reassurance and expert knowledge, the Nurse Navigators assist cancer patients in navigating the complex maze from diagnosis through the prescribed treatment and recovery phases of their illness. Additional support is given through education regarding medication and self-care requirements. The Navigators work with the network of specialists and technicians to ensure that the succession of tests and treatments are expedited in the best sequence with full consideration of the patient's needs.
- Transportation & Prescription Voucher Assistance: the Hospital provides a no-cost transportation service for patients requiring radiation oncology treatment who struggle with transportation - with a special emphasis on providing the service for the elderly. Transportation vouchers are supplied to patients in urgent situations and prescription vouchers are given to help to defray costs for patients who are unable to pay for medication.
- Financial Counseling: the Hospital provides information about its financial assistance program to all patients and makes this assistance available to individuals who meet established guidelines. Financial Counselors and social workers are available to answer questions and aid in the application process. In addition, the Hospital has an internal committee that monitors its financial assistance processes, reviews guidelines for appropriateness, and makes adjustments as needed to ensure optimal accessibility to the support.
- Alternative to Hospitalization Program (ATH): ATH is a collaborative system offered in the Hospital's Emergency Department where staff works with state behavioral health services to identify eligible individuals for linkage to community-based substance abuse treatment programs.
- Women, Infants and Children (WIC) Program: WIC serves to safeguard the health of low-income women, infants, and children up to age five who are at nutritional risk by providing nutritious foods to supplement diets, information on healthy eating, and referrals to health care. Middlesex Hospital recently became the local subcontractor for

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

WIC when the City of Middletown Health Department, after 25 years, was unable to renew the contract. In addition, due to significant city budget cut-backs, the Middletown program had merged with another county, which made accessibility challenging for local WIC clients. When community members suggested the Hospital assume the program, the Hospital agreed with the importance of keeping the program local, improving accessibility of services, and responding to community need. The service currently resides under the Hospital's comprehensive Family Advocacy Maternal Child Health program which provides support and outreach to a segment of the community's at-risk population.

Health Professions Education

Helping to prepare future health care professionals is a long-standing commitment of Middlesex Hospital and distinguishing characteristic that constitutes a significant community benefit. Year round, the Hospital supports health professions education for medical students, nursing students and technicians. The nationally respected *Middlesex Hospital Family Medicine Residency Program* graduates an impressive number of Family Practice physicians, many of whom continue to practice in the Middlesex County area after their training is complete. For more than 35 years the Hospital's Family Medicine Residency Program has trained physicians for a future in family practice. The educational curriculum encompasses a balanced approach in the domains of practical experiences and academics; independent and supervised study; office practice and hospital care; biomedical and psychosocial issues; personal medical care and community health perspectives; and core requirements and self-directed learning. Specialty tracks include: maternal/child; palliative medicine/geriatric; international health; integrative medicine; academic and leadership. To strengthen commitment to community health, each resident is required to participate in a community project as a means of understanding the community's available resources and health needs. Many of the residency projects have developed into on-going support programs for community members.

In addition to its Family Practice residents, the hospital welcomes medical and nursing student interns and provides on-site training during clinical rotations. Nursing students from local colleges and programs receive hands-on mentorship in the majority of clinical service lines year-round. For the nursing students, a good portion of the student-staff interaction is 1:1. The objective of the rotational format is to complement classroom learning with practical application;

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

expose students to the integration of evidence based practice; train students in the care for patients with complex needs; and aid students in developing the organizational, interpersonal, and critical thinking skills needed to enter the field of nursing. Other healthcare professional education includes: the Hospital's Radiology School - a 50+ year old program that graduates radiologic technologists with an associates degree, prepares them to pass the national certification test for radiographers and quality for state licensure, and operates at a loss for the Hospital; and clinical educational student training in the fields of pharmacy, social work, hospice, behavioral health, nuclear medicine, rehabilitation and physical therapy, infection prevention, phlebotomy, emergency responders, surgical services, among other areas of healthcare. In addition to teaching within the walls of the hospital, staff members continuously work with non-Hospital employed health care providers and agencies in the community – topics have included (but are not limited to): stroke education, smoking cessation, chronic obstructive pulmonary disease, nutritional counseling, asthma, diabetes, chronic heart failure, childhood obesity, stress management, fall prevention, mammography, pain management, H1N1, elder care, health literacy, nurturing parenting training, child and adolescent behavioral health, and psychological testing. The Hospital's paramedics share their knowledge with health providers in the community on an on-going basis by providing regular EMS in-service training to volunteer emergency medical service organizations such as fire departments and ambulance associations.

Subsidized Health Services

The Hospital's subsidized health services represent a significant portion of Middlesex Hospital's annual community benefit aggregate financials and numbers served. Subsidized services are particular clinical programs provided to the community despite a financial loss, with negative margins remaining after specific dollars (charity care and bad debt) and shortfalls (Medicaid) are removed. In order to qualify as a subsidized service, the program must meet certain health delivery criteria; meet an identified need in the community; and would become unavailable or the

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

responsibility of a governmental or another not-for-profit agency to provide if the Hospital discontinued the service. Middlesex Hospital's subsidized services for include Family Practice Group, Behavioral Health (inpatient and outpatient), Homecare, Cardiac Rehabilitation, Paramedics, Hospice, Wound Care and Pulmonary Rehabilitation.

- Family Practice Group: The Family Practice Group of Middlesex Hospital is made up of twelve faculty physicians and twenty-four resident physicians who are completing their four-year training in the specialty of Family Medicine (note: faculty and residency costs are captured under Health Professions Education). The group has been providing high-quality medical care to Middlesex County's community members since 1974. The practice serves patients of all ages with health care often coordinated for the entire family. Referrals to specialists are made when needed, with the Family Practice physician following patient care jointly with the specialist. In addition to caring for patients in the office, the Family Practice physicians follow the care of their patients when they in Middlesex Hospital and some local nursing and convalescent homes. If the need arises and patients are confined to their homes, house calls can also be arranged. The Family Practice Group is comprised of three locations: Middletown, East Hampton and Portland. Nurse health educators are available in the three family practice offices to provide counseling on health-related topics that promote a healthy lifestyle. The offices are equipped for comprehensive preventive health care procedures such as Pap smears, vision and hearing testing, pulmonary function testing, and electrocardiograms. Minor surgical procedures can also be performed in all three offices. As the Family Practice group is within the Middlesex Hospital Health System, it relies on the broad services offered by the system. Services include access to multiple laboratory facilities for routine tests, counseling among many other outpatient service lines. In addition, all faculty physicians and resident physicians are on the staff of Middlesex Hospital. Middlesex Hospital's Family Practice group is a critically important subsidized outpatient service as it fills a gap in primary care services and addresses access to care challenges. Middlesex County has been designated by the Health Resources and Services Administration (HRSA) to be a Medically Underserved Area experiencing a shortage of select health services which include too few primary care providers. In addition, HRSA reports that Middlesex County is a Health Professional Shortage Area (HPSA) for primary medical care.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

- Middlesex Hospital's Behavioral Health Program: provides a large spectrum of behavioral health services, including inpatient and outpatient therapy and support, child and adolescent services and a maternal child health program – and is heavily subsidized by the Hospital. The Hospital recognizes that the life disruptions caused by mental illness, severe behavioral problems, and addiction especially coupled with medical complexities can be devastating for patients and their families and is committed to providing the highest standard of care for both the physical and behavioral health needs of its psychiatric patients. Treatment is provided regardless of the patient's background and/or ability to pay. The behavioral health system at Middlesex Hospital is premised on guiding principles designed to empower each individual to attain optimal functioning in a compassionate, supportive, professional, collaborative environment. Each care plan is individualized with careful consideration of the patient's physical and mental needs and preferences. The Hospital has a 20 bed psychiatric unit for patients requiring inpatient stays; Day Treatment Program that provides intensive outpatient and partial hospital services for adolescents, adults and geriatric patients with psychiatric and co-occurring substance abuse/ psychiatric disorders; Outpatient Behavioral Health Clinic that offers treatment in individual, family, and group therapy to meet general adult and senior psychiatric needs; Family Advocacy Program (FAP) that offers comprehensive psychiatric services designed to improve the lives of children, adolescents and their families and improve access to critical resources; and FAP Maternal Child Health which provides primary prevention, case management and home-based parenting skill building wrap around and support services for at-risk first time families involved in Department of Children and Families (DCF).
- Middlesex Hospital Homecare: Recognizing the need for medical services for patients who are homebound, the Hospital's Homecare department, founded in 1900, makes over 160,000 visits per year to community residents with services available 7 days/week, 24 hours/day. While the program requires subsidy from the Hospital, it meets a vital need in community health. Staffing includes specialty nurses, home health aides, physical therapists, occupational therapists, speech therapists, medical social workers and nutritionists. The broad array of comprehensive services offered to meet the needs of the homecare patient encompass: 1) behavioral; 2) diabetes care and education; 3) specialized cardiac care; 4) geriatric care which focuses on the special needs of senior

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

patients and includes management of conditions, complex medications and/or long-term illness; 5) infusion therapy; 6) the emergency response Lifeline program; 7) maternal/child health services; 8) hospice and palliative care services; 9) psychiatric nursing for patients with primary psychiatric illness living in the community; 10) medical rehabilitation; 11) respiratory/pulmonary care; 12) wound/ostomy care; and 13) various community health services including flu shots and health fairs.

- Middlesex Hospital Cardiac Rehabilitation: Cardiac Rehabilitation is a service offered by Middlesex Hospital due to community request. In response, the Hospital makes this comprehensive program available to its community members despite a financial loss. The service includes progressive cardiac-monitored exercise plans customized per individual, risk-factor education, and is designed to assist patients who have had a recent heart attack, cardiac bypass, cardiac valve surgery, coronary angioplasty, or newly stabilized angina symptoms in achieving a speedy recovery and a healthy, productive lifestyle. Services for patients (and often their caregivers) include education on diagnosis, plan of care, and the requirements necessary to best manage their condition; discussion regarding appropriate lifestyle modifications given the new diagnosis; support to help diminish the fear of appropriate exercise and guidance on level of exertion and pulse rate monitoring; and symptom management education and recognition.
- Middlesex Hospital Paramedics Service: provides 24 hours/day, 7 days/week skilled emergency care and critical treatment to patients prior to arrival at the hospital. Paramedics work alongside fire and EMS personnel and are an important adjunct to emergency transport services, often administering care and providing advanced life support to the patient in the ambulance en route to the hospital – having care begin at the earliest opportunity is vital for best outcomes, particularly in cases of stroke and cardiac emergencies. Middlesex Hospital’s paramedic program is one of three such hospital-based services in the State – its mission is to provide high quality, cost-effective, community focused emergency medical services to those who require immediate response. Patients receive the best possible paramedic level of care, regardless of their ability to pay or condition. Since inception of the service, the Hospital has covered the program’s annual financial shortfalls.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

- Middlesex Hospital's Hospice Program: is committed to caring for the terminally ill and their families by enhancing quality of life for the patient. Services include comfort care with relief of physical symptoms, the provision of emotional and spiritual support, and the desire to support the patient's right to make choices and remain as autonomous as possible during this phase of life. As terminal illness brings a host of new and difficult challenges for both patient and family, the Hospital's Hospice program views patient and family as a single unit of care. Care is delivered through an interdisciplinary team that includes physicians, nurses, social workers, physical therapists, occupational therapists, nutritionists, home health aides, spiritual support, pharmacists, bereavement counselors, and specially-trained volunteers. The care setting includes home hospice as well as an inpatient unit designed to provide short-term care for patients requiring pain and symptom control as well as respite care during the last days of life. This vital community program functions at a loss for the Hospital. The Hospital also offers outpatient Palliative Care services which assist patients and families with critical decisions while providing maximum physical comfort and emotional support. Outpatient Palliative care services include pain and symptom control, psychosocial support, patient education about self-determination and advance directives, negotiating end-of-life decisions, and helping patients and loved ones understand and cope with the process of dying.
- Middlesex Hospital Wound Care: The Hospital performed a study and found that there was a gap in outpatient services for those experiencing complex and chronic wounds. In response, the Hospital created the Wound Care Center where a full range of services for effective wound treatment is provided. Clinical providers at both of the Hospital's Wound Care Center locations aid in determining what local or systemic factors are impeding the healing process, and assist in developing a specialized and individualized treatment care plan. Using a planned, systematic approach which includes consideration of all factors that affect wound healing, the Center treats four primary wound types: venous stasis ulcers, diabetic foot ulcers, ischemic ulcers and stage III and IV pressure ulcers. The Wound Care Center functions at a loss for the hospital and requires subsidy.
- Pulmonary Rehabilitation: The Hospital's Pulmonary Rehabilitation program was developed in direct response to the health assessment findings which identified half the adult population in Middlesex County to be at risk for COPD (18% are current smokers and 33% are former smokers). The study recommended development of a COPD

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

pathway and program. In response, an inpatient COPD pathway was generated in conjunction with a supporting outpatient pulmonary rehabilitation program. The program is one of both education and exercise classes – it teaches patients about their lungs, how to exercise and do activities with less shortness of breath, and how to live better with a lung condition. Pulmonary Rehabilitation is offered to any patient with impaired pulmonary endurance. The Pulmonary Rehab program offers the Better Breather’s Club, an adjunct service formed to help patients with respiratory diseases cope with their difficulties. The free support group is for community members with COPD, asthma and other chronic lung disease and is run by a respiratory therapist and invites pertinent guest speakers to enhance the education of the patient and their families about the respiratory illness from which they suffer. Pulmonary Rehab functions at a loss and requires Hospital subsidy in order to continue to be available to the community.

Research

Middlesex Hospital conducts research in the domains of clinical and community health. Clinical examples include national trials by the Hospital’s Cancer Center for breast, lung, prostate, colorectal, among others.

The Hospital’s Behavioral Health Department conducts clinical trials for a variety of health diagnoses with its outpatient clinic undergoing a major depressive disorder in adults study and with Family Advocacy continuing its participation in studies for major depression in children and adolescents. The Hospital continues to participate in the 5 year Physician Group Demonstration Project, a national community health initiative with The Centers for Medicare and Medicaid Services (CMS) designed to determine the feasibility of working with physician groups to improve the quality of care, patient outcomes and the cost efficiency of health care services. Middlesex is one of ten groups throughout the U.S. to participate.

Financial and In-Kind Contributions

Middlesex Hospital supports the community in the form of financial and in-kind contributions. The Hospital’s in-kind contributions include equipment, food, linens and medical supplies that are donated both locally and globally. The Hospital regularly donates collected medical supplies to an international organization as well as to the Sayaxche Hospital in Guatemala, as part of the

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

Middlesex-Sayaxche Project, an initiative linking Middlesex Community with a sister health system in Guatemala intended to bolster the healthcare infrastructure in one of the poorest regions of the country. Other in-kind donations include absorption of costs of copies of health information records for patients who cannot afford to pay for them, cafeteria discounts for YMCA residents, and staff coordination of community support drives including the United Way, Adopt-A-Family holiday gift program, American Cancer Society Daffodil Days, Families Feeding Families, Lions' Club eyeglasses and hearing aid collection, Cell Phones for Soldiers, Light One Little Candle and Reach Out and Read childhood readership. The Hospital's main campus and satellite locations make meeting space available, free-of-charge and on an on-going basis, for many community groups that would otherwise struggle to pay for space. Examples of community programs that utilize hospital space include (but are not limited to): CT Parkinson's meeting group, CT Unity, Asperger Spouse & Family Support Group, Face Forward Peer to Peer Support Group with Schizophrenia and Schizoaffective Disorder, National Alliance Mentally Ill, and local nursing school programs. In addition, each year the Hospital makes substantial cash donations to carefully selected mission-driven community organizations throughout its service area. Examples include (but are not limited to): transportation for the elderly and continuation of a large annual contribution to the Middlesex Chamber of Commerce AskMe3 health literacy initiative designed to promote awareness and working solutions for low literacy and its direct health impact by providing essential skills for patients and providers during any patient-provider interaction/conversation. Support of the global community is exemplified by the Hospital's annual sponsorship of a delegation from Sayaxche, Guatemala to spend a week of education and training at the Hospital, covering airfare and all related expenses.

Community Building Activities

Middlesex Hospital's participation in Community Building activities has a vital role in continuing to promote health and well-being for residents in its service area and, in some cases, the international community. The Hospital offers its resources and expertise to support and strengthen community assets in a variety of programs that fall under the scope of community building. Staff members are highly participative in community partnerships and coalitions, the success of which are greatly enhanced by Hospital collaboration - many community initiatives would not be as effective without the Hospital's administrative and clinical staff in-kind involvement, support and expertise. The Hospital's participation in all community building activities are solely to benefit the community's health and well-being by improving access to

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

health services and enhancing overall public health and in no case is the motivation for marketing purposes. Examples include (but are not limited to) staff involvement in: the Middlesex Chamber of Commerce's Prevention Committee, Safety Committee and Healthcare Council; United Way School Readiness Community Impact Team; United Way Community Impact Council; Middlesex Community Council; Safe Kids; Interfaith Council of Middletown; Middletown's 10 Year Plan To End Homelessness; Middlesex Elderly Service Providers; St. Luke's Gatekeeper Program; Valley Shore YMCA; State of CT Stoke Committee; State of CT Childhood Obesity Group; Association For Ambulatory Behavioral Healthcare; Middlesex County Children's Coalition; Middlesex Community College Advisory Board For Human Services; CT Council for Child & Adolescent Psychology; Middletown School System Safety Committee; Community Flu Preparation Committee. The following four programs highlight the importance of the Hospital's involvement in community building activities:

- **Community Care Team:** Middlesex Hospital's last health assessment found that in Middletown, Emergency Department (ED) visit rates for alcohol dependence was two times higher than State and peer county benchmarks. In response, the Hospital placed a Health Promotion Advocate in the ED to coordinate care for this target population, and the Community Care Team (CCT) was developed as a community-based solution to a community-wide problem. The CCT is comprised of community agencies that specialize in the delivery of care for substance use and mental disorders. The team's objective is to provide patient-centered care and improve health outcomes by developing and implementing a safety-net of alternative services through multi-agency intervention and care planning. When a patient has entry through the ED, the Health Promotion Advocate coordinates care and acts as liaison to the CCT. The team meets on a weekly basis to review cases, uncover service gaps and develop individualized care plans of wrap-around services that best meet the needs to the specific patient. As the patient travels through the continuum of care he/she is linked to appropriate inpatient and outpatient services. For those who experience homelessness, linkage to stable living is included in the care planning. Through collaboration and open communication, the CCT has strengthened relationships with key stakeholders and community organizations and has improved patient outcomes and quality of life for those who struggle with the disease of severe alcoholism (and co-occurring diagnoses).

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Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

- Opportunity Knocks (OK) was formed in 2003 when three Middletown community leaders specializing in early childhood development - Middlesex Hospital's Medical Director of Nurseries & Pediatric Faculty for the Family Practice Residency Program, Middlesex Hospital's Family Advocacy Maternal Child Health Program supervisor and Middletown's School Readiness coordinator – recognized that the health and developmental needs of Middletown's high-need young children could best be met through a coalition that crossed a variety of sectors. The multidisciplinary community coalition comprised of local health and social service agencies, early care and education providers, not-for-profit organizations and parents established goals that focused on the health and well-being of at-risk children ages 0-5. Since the inception of the program, Opportunity Knocks has served approximately 5,000 children ages 0-5 and countless family members. Middlesex Hospital provides OK's program planner, physician champion, grant-writing support and fiscal administration for the funding sources. In addition, staff members from multiple Hospital departments actively participate in the collaborative, including representatives from Family Advocacy Maternal Child Health, Diabetes Management, Asthma Management, Fit For Kids, Family Practice, the Family Medicine Residency program, and the Pregnancy & Birth Center.
- The Middlesex Hospital-Sayaxche Community Partnership extends the Hospital's involvement in community health to the global community. The goal of the project, started in 2008, is to establish a long-term, collaborative, mutually beneficial and ethically sound partnership between Middlesex Hospital and Middletown, CT community with the healthcare infrastructure of the Peten region in Guatemala, including Sayaxche Hospital, the Ministry of Health and the local health promoters.

Based on a needs assessment conducted by Middlesex Hospital employees at the Sayaxche Hospital, the partnership has focused on addressing multiple areas of priority. Annual visits by delegations from Sayaxche to Middlesex Hospital, with the purpose of education and training in key areas, are underwritten by the Hospital. The Hospital contributes funding earmarked for the project; in-kind staff hours; donated supplies; and hosts a local community collaborative committee comprised interested agencies. The committee's objective is to set achievable goals that will improve access to health services by strengthening the health care infrastructure of the target population in the Peten region.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

- The Hospital partakes in many good neighbor community activities outside of the scope of the healthcare delivery system; such participation often incurs significant expense to the Hospital. For Disaster Readiness, the Hospital plays a pivotal role by working in collaboration with key community partners to ensure the safety of the community at large during a potential disaster. Hospital employees participate on multiple community boards and initiatives designed specifically to address disaster preparedness, control and address the ongoing overall safety of the community. Only the activities and associated cost which exceed licensure and standard practice requirements are included in the Hospital's community benefit inventory. Disaster readiness requires a comprehensive, community-wide coordinated effort for coping with such emergencies as natural disasters, infectious disease outbreaks, bio terrorism, or acts of civil unrest. Hospital security staff, paramedics, infectious diseases specialists, nursing and medical staff are all involved in the continuing effort to be prepared for whatever community emergencies might arise. Examples include participation in community disaster preparation committees, community education and natural disaster drills; pandemic preparedness and stockpiling of supplies that exceeds regulatory standards; and hosting yearly radiation drills for the staff of a local nuclear power plant where Hospital staff train power plant workers (at no-cost) on protocols for internal contamination.
- Middlesex Hospital's Shoreline Medical Center (SMC) is committed to working with local schools to introduce the concept of a medical career in a full range of medical related professions and reinforce the importance of continuing one's education. Each year SMC hosts a multidisciplinary Career Day, World of Work, and oversees high school student mentorship. In response to a looming nursing shortage a dedicated nurse at SMC created Career Day, an annual event where students from the community can experience an emergency in real time and learn what it's like to be a health professional. An additional benefit of Career Day includes spurring many high school students to intern at SMC throughout the school year – the internship provides a unique opportunity for students to receive direct mentorship from health care professionals and exposure to a variety of health delivery disciplines. As a result, many have chosen to pursue careers in health post high school graduation. Yet Another program designed specifically to encourage a career in health is SMC's World of Work where students from a local middle school spend half a day on-site learning about paramedics and emergency medical services, radiology, nursing and laboratory services. The idea is to foster an interest in health as a career at an early age.

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

Community Benefit Operations

Community Benefit Operations include activities and costs associated with community benefit strategic planning, administration, and health assessment production and execution. Middlesex Hospital has a dedicated manager of community benefit, along with a community benefit steering committee (comprised of hospital leadership) that oversees community benefit planning and operations.

For the past several years the Hospital has used its most recent health assessment as the basis of its community benefit priority areas and in response, extensive internal and external collaborations have focused on areas of identified need. In FY12, the Hospital joined the Middlesex County Coalition on Community Wellness (MCCCW) which includes members from the sectors of public health, healthcare, social services, community services and education. The Coalition's goal is to work together to conduct a community health needs assessment, identify key issues that impact the health and wellbeing of the communities serviced, and develop collaborative programs to meet identified need. The Hospital is a key partner in the MCCCW. The community health needs assessment is scheduled to be completed in FY13.

Financial Assistance (Charity Care)

Charity care includes free or discounted health services provided to persons who cannot afford to pay and who meet the Hospital's criteria for financial assistance. Great concern is taken to make sure that patients are informed of the availability of patient assistance funding programs. Signs (in English and Spanish) are posted in conspicuous places within the Hospital, including registration, administration, the emergency department, social services, billing, and waiting rooms. A Patient Guide is provided upon registration which outlines patient billing and financial services. The guide answers questions regarding available financial assistance qualifications and application processes. A financial assistance brochure is made widely available throughout the organization. Contact information is provided so that patients can easily reach a financial counselor to assist them. Applicants are screened for financial eligibility and assistance is provided to complete the paperwork. To ensure that the Hospital's generous financial assistance program is accessible, a Financial Assistance Workgroup was formed in 2008 to review all

Middlesex Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(amounts in thousands)

15. Community Benefit (Unaudited) (continued)

processes related to the financial assistance process, including user-friendliness of the application, expansion of charity care awards, and enhanced communication regarding the financial assistance availability. The Workgroup continues to meet to monitor and update, when needed, protocols related to charity care.

State Sponsored Health Care, Unpaid Costs

Community benefits related to government sponsored programs include the unpaid cost of specific public programs. In FY2012 payments received for Medicaid services provided by the Hospital did not cover the actual cost of providing these services; these unpaid costs are reported in the financial statement.

Report of Independent Auditors on Supplementary Information

The Board of Directors
Middlesex Health System, Inc.

We have audited the consolidated financial statements of Middlesex Health System, Inc. (the System) as of and for the year ended September 30, 2012, and have issued our report thereon dated January 28, 2013, which contained an unqualified opinion on those consolidated financial statements. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating balance sheet and statement of operations are presented for the purposes of additional analysis and is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Ernst & Young LLP

January 28, 2013

Middlesex Health System, Inc. and Subsidiaries

Consolidating Balance Sheet

September 30, 2012

(in thousands)

	Middlesex Hospital	Middlesex Health System, Inc.	Middlesex Health Services, Inc.	Eliminations	Sub-Total Obligated Group	Middlesex Health Resources, Inc.	MHS Primary Care, Inc.	Eliminations	2012 Consolidated
Current assets:									
Cash and cash equivalents	\$ 54,769	\$ 15	\$ 1,102	\$ –	\$ 55,886	\$ 1,466	\$ 1,216	\$ –	\$ 58,568
Short-term investments	10,187	–	–	–	10,187	–	–	–	10,187
Patient accounts receivable, net	45,169	–	23	–	45,192	–	759	–	45,951
Other receivables	3,653	–	–	–	3,653	63	–	–	3,716
Prepaid and other	3,503	–	7	–	3,510	163	99	–	3,772
Current portion of investments limited as to use	4,527	–	86	–	4,613	–	–	–	4,613
Total current assets	121,808	15	1,218	–	123,041	1,692	2,074	–	126,807
Investments limited as to use	118,942	–	146	–	119,088	–	–	–	119,088
Long-term investments	15,481	–	–	–	15,481	–	–	–	15,481
Other assets:									
Due from related parties	103	–	–	(15)	88	–	–	(88)	–
Investments in joint ventures and limited partnerships	–	–	–	–	–	47	–	–	47
Other	3,905	–	89	–	3,994	11	–	(27)	3,978
Total other assets	4,008	–	89	(15)	4,082	58	–	(115)	4,025
Property and equipment, net	179,846	–	4,748	–	184,594	2,445	1,947	–	188,986
Total assets	\$ 440,085	\$ 15	\$ 6,201	\$ (15)	\$ 446,286	\$ 4,195	\$ 4,021	\$ (115)	\$ 454,387

Middlesex Health System, Inc. and Subsidiaries

Consolidating Balance Sheet (continued)

September 30, 2012

(in thousands)

	Middlesex Hospital	Middlesex Health System, Inc.	Middlesex Health Services, Inc.	Eliminations	Sub-Total Obligated Group	Middlesex Health Resources, Inc.	MHS Primary Care, Inc.	Eliminations	2012 Consolidated
Current liabilities:									
Current portion of long-term debt and capital leases	\$ 4,618	\$ –	\$ 255	\$ –	\$ 4,873	\$ –	\$ 64	\$ (22)	\$ 4,915
Accounts payable	19,149	–	172	–	19,321	55	240	–	19,616
Due to related parties	–	–	15	(15)	–	6	82	(88)	–
Accrued payroll and related liabilities	32,727	–	–	–	32,727	–	1,185	–	33,912
Estimated third party payor settlements	2,944	–	–	–	2,944	–	–	–	2,944
Other accrued liabilities	2,099	–	148	–	2,247	–	57	–	2,304
Current portion of estimated self-insurance liability	8,064	–	69	–	8,133	–	–	–	8,133
Current portion of accrued retirement liabilities	48	–	–	–	48	–	–	–	48
Total current liabilities	69,649	–	659	(15)	70,293	61	1,628	(110)	71,872
Other liabilities:									
Long-term debt and capital leases, net of current portion	63,332	–	5,103	–	68,435	–	953	(5)	69,383
Estimated self-insurance liability, net of current portion	5,447	–	–	–	5,447	–	–	–	5,447
Accrued retirement liabilities, net of current portion	129,719	–	–	–	129,719	–	–	–	129,719
Estimated third party payor settlements and other	10,933	–	–	–	10,933	109	114	–	11,156
Total other liabilities	209,431	–	5,103	–	214,534	109	1,067	(5)	215,705
Net assets:									
Unrestricted	144,992	15	293	–	145,300	4,025	1,326	–	150,651
Temporarily restricted	9,049	–	146	–	9,195	–	–	–	9,195
Permanently restricted	6,964	–	–	–	6,964	–	–	–	6,964
Total net assets	161,005	15	439	–	161,459	4,025	1,326	–	166,810
Total liabilities and net assets	\$ 440,085	\$ 15	\$ 6,201	\$ (15)	\$ 446,286	\$ 4,195	\$ 4,021	\$ (115)	\$ 454,387

Middlesex Health System, Inc. and Subsidiaries
 Consolidating Statement Operations and Changes in Net Assets

September 30, 2012
 (in thousands)

	Middlesex Hospital	Middlesex Health System, Inc.	Middlesex Health Services, Inc.	Eliminations	Sub-Total Obligated Group	Middlesex Health Resources, Inc.	MHS Primary Care, Inc.	Eliminations	2012 Consolidated
Unrestricted revenues:									
Net patient service revenue	\$ 347,836	\$ —	\$ 2,918	\$ —	\$ 350,754	\$ —	\$ 10,712	\$ —	\$ 361,466
Other revenue	11,871	892	6	(942)	11,827	789	551	(633)	12,534
Total unrestricted revenues	359,707	892	2,924	(942)	362,581	789	11,263	(633)	374,000
Operating expenses:									
Salaries and wages	161,675	569	1,333	(569)	163,008	—	8,962	—	171,970
Fringe benefits	37,632	97	356	(97)	37,988	—	1,633	—	39,621
Purchased services	25,861	153	212	(153)	26,073	—	406	—	26,479
Supplies	34,609	73	171	(73)	34,780	—	596	—	35,376
Depreciation and amortization	21,449	—	203	—	21,652	189	274	—	22,115
Interest	3,106	—	241	—	3,347	—	58	—	3,405
Provision for bad debts	12,199	—	—	—	12,199	—	57	—	12,256
Other operating expenses	38,006	—	362	(50)	38,318	579	2,171	(633)	40,435
Total operating expenses	334,537	892	2,878	(942)	337,365	768	14,157	(633)	351,657
Income (loss) from operations	25,170	—	46	—	25,216	21	(2,894)	—	22,343
Other income (expense):									
Net income from joint ventures and general partnerships	2,176	—	—	—	2,176	48	—	—	2,224
Unrestricted gifts and bequests	467	—	—	—	467	—	—	—	467
Net investment income	2,153	—	—	—	2,153	8	—	—	2,161
Other non-operating expenses	(892)	—	—	—	(892)	(54)	—	—	(946)
Total other income, net	3,904	—	—	—	3,904	2	—	—	3,906
Excess (deficit) of revenues over expenses	29,074	—	46	—	29,120	23	(2,894)	—	26,249
Net assets, beginning of year									
Net assets, beginning of year	138,072	15	292	—	138,379	3,944	1,222	—	143,545
Change in unrealized gains and losses	13,973	—	—	—	13,973	—	—	—	13,973
Restricted net realized gains and losses	222	—	—	—	222	—	—	—	222
Restricted contributions	2,973	—	118	—	3,091	—	—	—	3,091
Change in accumulated pension charges to unrestricted net assets									
Change in accumulated pension charges to unrestricted net assets	(19,085)	—	—	—	(19,085)	—	—	—	(19,085)
Transfers	(2,998)	—	—	—	(2,998)	—	2,998	—	—
Additional paid-in-capital	—	—	—	—	—	58	—	—	58
Expenditures for intended purposes	(1,226)	—	(17)	—	(1,243)	—	—	—	(1,243)
Net assets, end of year	161,005	15	439	—	161,459	4,025	1,326	—	166,810

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