

CONSOLIDATED FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION

The New Milford Hospital, Incorporated and Subsidiaries  
Years Ended September 30, 2012 and 2011  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

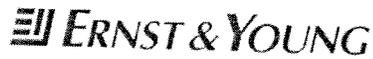
The New Milford Hospital, Incorporated and Subsidiaries

Consolidated Financial Statements  
and Supplementary Information

Years Ended September 30, 2012 and 2011

**Contents**

|   |    |
|---|----|
| Report of Independent Auditors.....                                   | 1  |
| Consolidated Financial Statements                                     |    |
| Consolidated Balance Sheets .....                                     | 2  |
| Consolidated Statements of Operations and Changes in Net Assets ..... | 4  |
| Consolidated Statements of Cash Flows.....                            | 6  |
| Notes to Consolidated Financial Statements.....                       | 7  |
| Supplementary Information   |    |
| Report of Independent Auditors on Supplementary Information .....     | 30 |
| Years Ended September 30, 2012 and 2011                               |    |
| Consolidating Balance Sheets.....                                     | 31 |
| Consolidating Statements of Operations.....                           | 33 |



Ernst & Young LLP  
Goodwin Square  
225 Asylum Street  
Hartford, CT 06103-1506  
Tel: +1 860 247 3100  
Fax: +1 860 725 6040  
www.ey.com

## Report of Independent Auditors

Board of Directors  
The New Milford Hospital, Incorporated and Subsidiaries

We have audited the accompanying consolidated balance sheets of The New Milford Hospital, Incorporated and Subsidiaries (the Hospital) as of September 30, 2012 and 2011, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The New Milford Hospital, Incorporated and Subsidiaries at September 30, 2012 and 2011, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

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

*Ernst & Young LLP*

January 25, 2013

The New Milford Hospital, Incorporated and Subsidiaries

Consolidated Balance Sheets

|   | September 30         |                      |
|---|----------------------|----------------------|
|   | 2012                 | 2011                 |
| <b>Assets</b>   |                      |                      |
| Current assets:   |                      |                      |
| Cash and cash equivalents   | \$ 6,281,016         | \$ 12,675,086        |
| Accounts receivable, less allowance for uncollectible<br>accounts of approximately \$2,387,000 in 2012 and<br>\$2,311,000 in 2011 | 8,601,320            | 10,457,444           |
| Current portion of assets limited as to use   | 1,200,000            | 1,200,000            |
| Current portion of pledges receivable   | 900,631              | 117,660              |
| Inventories   | 1,645,080            | 1,944,478            |
| Prepaid expenses and other  | 900,544              | 1,415,605            |
| Total current assets  | <u>19,528,591</u>    | <u>27,810,273</u>    |
| Investments   | 2,706,138            | 2,755,954            |
| Assets limited as to use:   |                      |                      |
| Funds restricted by donor   | 421,160              | 525,763              |
| Beneficial interest in trusts held by others  | 4,134,546            | 3,686,841            |
| Total noncurrent assets limited as to use   | <u>4,555,706</u>     | <u>4,212,604</u>     |
| Other assets  | 4,541,461            | 1,402,833            |
| Property, plant, and equipment:   |                      |                      |
| Land and land improvements  | 1,544,196            | 1,546,857            |
| Buildings and building improvements   | 49,484,944           | 50,178,336           |
| Equipment and other   | 56,864,547           | 54,763,793           |
| Construction in progress (estimated cost to complete at<br>September 30, 2012: \$10,992,000)                                      | 298,414              | -                    |
|   | <u>108,192,101</u>   | <u>106,488,986</u>   |
| Less accumulated depreciation   | 75,751,426           | 71,743,955           |
|   | <u>32,440,675</u>    | <u>34,745,031</u>    |
| Pledges receivable, less current portion  | 2,602,193            | 156,148              |
| Total assets  | <u>\$ 66,374,764</u> | <u>\$ 71,082,843</u> |

|  | September 30      |                   |
|--|-------------------|-------------------|
|  | 2012              | 2011              |
| <b>Liabilities and net assets</b>                                  |                   |                   |
| Current liabilities:   |                   |                   |
| Accounts payable   | \$ 3,081,591      | \$ 4,262,947      |
| Payroll-related accruals   | 3,202,850         | 2,329,129         |
| Due to third-party payors  | 2,461,714         | 4,184,788         |
| Current portion of due to related parties                          | 5,057,706         | 4,028,167         |
| Other accrued expenses   | 460,952           | 1,116,330         |
| Current portion of long-term debt and capital lease obligations    | 495,090           | 509,773           |
| Total current liabilities  | <u>14,759,903</u> | <u>16,431,134</u> |
| Accrued pension liabilities and other                              | 26,239,675        | 17,644,845        |
| Due to related parties, less current portion                       | 3,815,518         | 5,203,150         |
| Long-term debt and capital lease obligations, less current portion | 1,013,765         | 1,414,718         |
| Net assets:  |                   |                   |
| Unrestricted   | 12,487,373        | 26,176,392        |
| Temporarily restricted   | 3,923,984         | 525,763           |
| Permanently restricted   | 4,134,546         | 3,686,841         |
| Total net assets   | <u>20,545,903</u> | <u>30,388,996</u> |

Total liabilities and net assets

\$ 66,374,764    \$ 71,082,843

*See accompanying notes.*

The New Milford Hospital, Incorporated and Subsidiaries  
Consolidated Statements of Operations and Changes in Net Assets

|  | Year Ended September 30 |               |
|--|-------------------------|---------------|
|  | 2012                    | 2011          |
| Unrestricted revenues:   |                         |               |
| Net patient service revenue  | \$ 81,236,073           | \$ 90,588,107 |
| Provision for bad debt <i>(see Note 1)</i>                         | 3,125,172               | 2,545,989     |
| Net patient service revenue less provision for bad debt            | 78,110,901              | 88,042,118    |
| Net assets released from restriction                               | 66,843                  | 204,673       |
| Other operating revenue  | 1,034,489               | 2,623,754     |
|  | 79,212,233              | 90,870,545    |
| Expenses:  |                         |               |
| Salaries, benefits and fees  | 51,817,496              | 53,344,078    |
| Supplies and other   | 25,778,114              | 29,943,627    |
| Insurance  | 1,643,424               | 1,611,492     |
| Depreciation and amortization                                      | 5,526,925               | 5,855,136     |
| Interest   | 419,014                 | 511,926       |
|  | 85,184,973              | 91,266,259    |
| Loss from operations   | (5,972,740)             | (395,714)     |
| Nonoperating income (loss):  |                         |               |
| Contributions  | 1,009,077               | 1,536,643     |
| Investment income, net   | 429,853                 | 235,285       |
| Change in unrealized gains and losses on investments               | (12,206)                | -             |
| Operating expenses of the New Milford Hospital<br>Foundation, Inc. | (654,269)               | (538,988)     |
|  | 772,455                 | 1,232,940     |
| (Deficiency) excess of revenues over expenses                      | (5,200,285)             | 837,226       |

*Continued on next page.*

The New Milford Hospital, Incorporated and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (continued)

|   | <b>Year Ended September 30</b> |               |
|---|--------------------------------|---------------|
|   | <b>2012</b>                    | <b>2011</b>   |
| Unrestricted net assets:  |                                |               |
| (Deficiency) excess of revenues over expenses (continued)               | <b>(5,200,285)</b>             | 837,226       |
| Change in fair value of interest rate swap                              | -                              | 156,640       |
| Net assets released from restrictions for property, plant and equipment | <b>207,624</b>                 | 569,726       |
| Transfers from temporarily restricted net assets                        | <b>16,879</b>                  | 4,870,661     |
| Change in pension funding obligation                                    | <b>(7,274,255)</b>             | (2,579,273)   |
| Acquisition of non-controlling interest in joint venture                | <b>(1,176,149)</b>             | -             |
| Termination of affiliations   | -                              | (3,005,447)   |
| Transfer to Western Connecticut Health Network Foundation, Inc.         | <b>(16,879)</b>                | -             |
| Other   | <b>(245,954)</b>               | (103,574)     |
| (Decrease) increase in unrestricted net assets                          | <b>(13,689,019)</b>            | 745,959       |
| Temporarily restricted net assets:                                      |                                |               |
| Contributions   | <b>3,689,567</b>               | 775,018       |
| Investment income, net  | -                              | 209,512       |
| Change in unrealized gains and losses on investments                    | -                              | (137,314)     |
| Net assets released from restriction                                    | <b>(66,843)</b>                | (204,673)     |
| Net assets released from restrictions for property, plant and equipment | <b>(207,624)</b>               | (569,726)     |
| Transfer to unrestricted net assets                                     | <b>(16,879)</b>                | (4,870,661)   |
| Increase (decrease) in temporarily restricted net assets                | <b>3,398,221</b>               | (4,797,844)   |
| Permanently restricted net assets:                                      |                                |               |
| Increase (decrease) in beneficial interest in trusts held by others     | <b>447,705</b>                 | (263,723)     |
| Increase (decrease) in permanently restricted net assets                | <b>447,705</b>                 | (263,723)     |
| Decrease in net assets  | <b>(9,843,093)</b>             | (4,315,608)   |
| Net assets at beginning of year   | <b>30,388,996</b>              | 34,704,604    |
| Net assets at end of year   | <b>\$ 20,545,903</b>           | \$ 30,388,996 |

See accompanying notes.

The New Milford Hospital, Incorporated and Subsidiaries

Consolidated Statements of Cash Flows

|  | Year Ended September 30 |                |
|--|-------------------------|----------------|
|  | 2012                    | 2011           |
| <b>Operating activities and other income</b>   |                         |                |
| Decrease in net assets   | \$ (9,843,093)          | \$ (4,315,608) |
| Adjustments to reconcile decrease in net assets to net cash (used in) provided by operating activities and other income: |                         |                |
| Depreciation and amortization  | 5,526,925               | 5,855,136      |
| Change in unrealized gains and losses on investments   | 12,206                  | 137,314        |
| Change in fair value of interest rate swap   | -                       | (156,640)      |
| Change in pension funding obligation   | 7,274,255               | 2,579,273      |
| Restricted contributions and investment income   | (3,689,567)             | (984,530)      |
| Change in beneficial interest in trusts held by others   | (447,705)               | 263,723        |
| Provision for bad debt   | 3,125,172               | 2,545,989      |
| Change in other  | 245,954                 | 103,574        |
| Changes in operating assets and liabilities (see Note 11)  | (8,187,745)             | 465,378        |
| Net cash (used in) provided by operating activities and other income   | (5,983,598)             | 6,493,609      |
| <b>Investing activities</b>  |                         |                |
| Additions to property, plant, and equipment, net   | (3,222,569)             | (7,587,394)    |
| Change in due to related parties   | (358,093)               | 9,231,317      |
| (Increase) decrease in investments, net and assets limited as to use   | (103,741)               | 3,246,863      |
| Net cash (used in) provided by investing activities  | (3,684,403)             | 4,890,786      |
| <b>Financing activities</b>  |                         |                |
| Proceeds from long-term debt   | -                       | 40,000         |
| Payments of long-term debt and capital lease obligations   | (415,636)               | (7,315,741)    |
| Restricted contributions and investment income   | 3,689,567               | 984,530        |
| Net cash provided by (used in) financing activities  | 3,273,931               | (6,291,211)    |
| Net (decrease) increase in cash and cash equivalents   | (6,394,070)             | 5,093,184      |
| Cash and cash equivalents at beginning of year   | 12,675,086              | 7,581,902      |
| Cash and cash equivalents at end of year   | \$ 6,281,016            | \$ 12,675,086  |

See accompanying notes.

# The New Milford Hospital, Incorporated and Subsidiaries

## Notes to Consolidated Financial Statements

September 30, 2012

### 1. Summary of Significant Accounting Policies

#### Organization and Basis of Presentation

The New Milford Hospital, Incorporated (the New Milford Hospital) is a voluntary, not-for-profit, non-stock corporation incorporated under the General Statutes of the State of Connecticut and is the sole corporate member of its subsidiary, New Milford Hospital Foundation, Inc. (collectively, the Hospital).

New Milford Hospital Foundation, Inc. (the Foundation), was established as a not-for-profit, non-stock corporation incorporated under the General Statutes of the State of Connecticut and is operated, in part, to maintain a capital campaign fund and solicit and receive contributions on behalf of the New Milford Hospital and other Section 501(c)(3) organizations affiliated with the New Milford Hospital.

Effective October 28, 2009, the New Milford Hospital formed a strategic partnership with Radcorp of New Milford, LLC. The partnership, New Milford MRI JV, LLC, offers MRI services located at New Milford Hospital. The New Milford Hospital owned a 51% share of New Milford MRI JV, LLC with the remaining 49% owned by Radcorp of New Milford, LLC. In 2012, the Hospital purchased Radcorp of New Milford, LLC's ownership share and New Milford MRI JV, LLC became a department of the Hospital. Prior to the acquisition of the remaining ownership interest, the partnership's capital accounts were in a deficit position.

The accompanying consolidated financial statements includes the accounts of the New Milford Hospital and the Foundation. All material intercompany accounts and transactions have been eliminated in consolidation.

The Hospital is a member of Western Connecticut Health Network, Inc. (WCHN). This affiliation allows the Hospital to retain separate licenses and operate autonomously, while promoting collaboration and efficiencies to provide innovative and accessible quality health care for residents of western Connecticut and adjacent eastern New York.

## The New Milford Hospital, Incorporated and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **1. Summary of Significant Accounting Policies (continued)**

##### **Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

##### **Regulatory Matters**

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

##### **Cash and Cash Equivalents**

Cash and cash equivalents consist of cash and short-term investments with a maturity of three months or less at date of purchase other than amounts held in the investment portfolio and assets limited as to use. Cash and cash equivalents are maintained with domestic financial institutions with deposits that exceed federally insured limits. It is the Hospital's policy to monitor the financial strength of these institutions.

##### **Patient Accounts Receivable**

Patient accounts receivable result from the health care services provided by the Hospital. Additions to the allowance for uncollectible accounts result from the provision for bad debt. Accounts written off as uncollectible are deducted from the allowance for uncollectible accounts.

The Hospital's estimation of the allowance for uncollectible accounts is based primarily upon the type and age of the patient accounts receivable and the effectiveness of the Hospital's collection efforts. The Hospital's policy is to reserve a portion of all self-pay receivables, including amounts due from the uninsured and amounts related to co-payments and deductibles, as these

## The New Milford Hospital, Incorporated and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

charges are recorded. On a monthly basis, the Hospital reviews its accounts receivable balances and various analytics to support the basis for its estimates. These efforts primarily consist of reviewing the following:

- Historical write-off and collection experience using a hindsight or look-back approach;
- Revenue and volume trends by payor, particularly the self-pay components;
- Changes in the aging and payor mix of accounts receivable, including increased focus on accounts due from the uninsured and accounts that represent co-payments and deductibles due from patients;
- Cash collections as a percentage of net patient revenue less the provision for bad debt; and
- Trending of days revenue in accounts receivable.

The Hospital regularly performs hindsight procedures to evaluate historical write-off and collection experience throughout the year to assist in determining the reasonableness of its process for estimating the allowance for uncollectible accounts.

The amount of the allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in Medicare and Medicaid health care coverage and other collection indicators. See Note 2 for additional information relative to third-party payor programs.

The Hospital's primary concentration of credit risk is patient accounts receivable, which consists of amounts owed by various governmental agencies, insurance companies and private patients. The Hospital manages the receivables by regularly reviewing its patient accounts and contracts, and by providing appropriate allowances for uncollectible amounts. Significant concentrations of gross patient accounts receivable include 37% and 6%, and 35% and 5%, for Medicare and Medicaid, respectively, at September 30, 2012 and 2011, respectively.

#### Fair Value of Financial Instruments

The carrying value of financial instruments classified as current assets and current liabilities as of September 30, 2012 and 2011 approximate fair value based on current market conditions. The fair values of other financial instruments are disclosed in the respective notes and/or in Note 4.

The New Milford Hospital, Incorporated and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

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

**Investments and Assets Limited as to Use**

During 2012, the Hospital determined that its investment portfolio was more accurately classified as trading, with unrealized gains and losses included in (deficiency) excess of revenues over expenses. In previous years, the Hospital's investments (see Note 3) were classified as other than trading securities. As such, unrealized gains and losses that were considered temporary were excluded from (deficiency) excess of revenues and expenses.

Investments, including funds restricted by donor, are recorded at fair value at the balance sheet dates. Investment income (including unrealized and realized gains and losses on investments, interest and dividends) is included in nonoperating income.

**Inventories**

Inventories, used in general operations of the Hospital, are stated at average cost.

**Property, Plant and Equipment**

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

**Nonoperating Income (Loss)**

Activities other than those in connection with providing healthcare services are considered to be non-operating. Non-operating gains primarily consist of income and unrealized gains and losses on invested funds and unrestricted donations and contributions. Non-operating losses include the operating expenses of the Foundation.

**(Deficiency) Excess of Revenues over Expenses**

The consolidated statements of operations and changes in net assets include the (deficiency) excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from (deficiency) excess of revenues over expenses include contributions of long-lived assets, including assets acquired using contributions which by donor

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

restriction were to be used for the purposes of acquiring such assets, change in pension funding obligation, transfers to related entities, termination of affiliations, acquisition of non-controlling interest in joint venture, and change in the fair value of interest rate swap.

Transactions deemed by management to be ongoing, major or central to the provision of health care services are reported within income from operations.

**Professional Liability Insurance**

Professional liability insurance coverage was provided under claims-made policies. The coverage limits are \$5,000,000 per claim and \$25,000,000 in the aggregate. The excess indemnity coverage is \$25,000,000 per claim and \$25,000,000 in the aggregate. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. Management estimates and records a liability for incurred but not reported incidents (IBNR). The Hospital has recorded \$1,439,898 and \$1,120,700 based on a discount rate of 3.5% and 3.0% as of September 30, 2012 and 2011, respectively. The actuarially determined present value of the IBNR is included within accrued pension liabilities and other on the consolidated balance sheets.

**Income Taxes**

The Hospital and the Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (IRC) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the IRC. The Hospital is also exempt from state and local taxes.

At September 30, 2012, the Hospital has net operating loss carryforwards from unrealized business activities of approximately \$1,040,000. These losses generate a potential deferred tax asset of approximately \$416,000, which is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future periods.

**Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time frame or purpose. Temporarily restricted net assets consist of contributions restricted for certain health care services.

## The New Milford Hospital, Incorporated and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **1. Summary of Significant Accounting Policies (continued)**

Permanently restricted net assets consist of assets held in trusts by others, which are to be maintained in perpetuity.

#### **Donor Restricted Gifts**

Unconditional promises to give cash and other assets to the Foundation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received and when the conditions are met. 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 to unrestricted net assets and reported in the consolidated statement of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

#### **Reclassifications**

Certain 2011 amounts have been reclassified to conform to the 2012 presentation. These reclassifications are not material to the overall consolidated financial statements.

#### **Adoption of New Accounting Standards**

In August 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (“ASU”) No. 2010-23, *Measuring Charity Care for Disclosure*. The new guidance requires that the level of charity care provided be presented based on the direct and indirect costs of the charity services provided. Separate disclosure of the amount of any cash reimbursements received for providing charity care must also be disclosed. The new disclosure requirements became effective for the Hospital on October 1, 2011 and are included in the accompanying consolidated financial statements for all periods presented (see Note 2).

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 for Certain Health Care Entities*. The new guidance requires the Hospital to change the presentation of its statement of operations by reclassifying the provision for bad debt associated with patient service revenue

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

(net of contractual allowances and discounts) from an operating expense to a deduction from patient service revenue. Additionally, the Hospital is required to provide enhanced disclosures about its policies for recognizing revenue and assessing bad debts, as well as qualitative and quantitative information about changes in the allowance for uncollectible accounts. The new guidance was adopted by the Hospital as of and for the year ended September 30, 2012 and retrospectively applied the presentation requirements for the year ended September 30, 2011.

In August 2010, the FASB issued ASU 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Recoveries*, which provides clarification to companies in the health care industry on the accounting for professional liability and similar insurance. ASU 2010-24 states that insurance liabilities should not be presented net of insurance recoveries and that an insurance receivable should be recognized on the same basis as the liabilities, subject to the need for a valuation allowance for uncollectible accounts. ASU 2010-24 is effective for fiscal years beginning after December 15, 2010 and was adopted by the Hospital during 2012. The adoption of this standard increased other assets by \$2,913,457 and accrued pension liabilities and other by \$2,913,457 in the consolidated balance sheet as of September 30, 2012 as compared to September 30, 2011.

**2. Net Patient Service Revenue and Charity Care**

The following table summarizes net revenues from services to patients by the Hospital:

|   | <b>Year Ended September 30</b> |                |
|---|--------------------------------|----------------|
|   | <b>2012</b>                    | <b>2011</b>    |
| Gross patient service revenue                           | <b>\$ 204,381,627</b>          | \$ 238,485,898 |
| Deductions:   |                                |                |
| Allowances  | <b>121,534,978</b>             | 145,313,145    |
| Charity care  | <b>1,610,576</b>               | 2,584,646      |
| Net patient service revenue                             | <b>123,145,554</b>             | 147,897,791    |
| Provision for bad debt                                  | <b>81,236,073</b>              | 90,588,107     |
| Net patient service revenue less provision for bad debt | <b>3,125,172</b>               | 2,545,989      |
|   | <b>\$ 78,110,901</b>           | \$ 88,042,118  |

Patient accounts receivable and revenues are recorded when patient services are performed.

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Net Patient Service Revenue and Charity Care (continued)**

During 2012 and 2011, approximately 31% and 7% and 29% and 7%, respectively, of net patient service revenue was received under the Medicare and Medicaid programs, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Hospital believes it is in compliance with all applicable laws and regulations. Changes in the Medicaid and Medicare programs and the reduction in funding levels could have an adverse impact on the Hospital.

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. The difference is accounted for as allowances. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, fee-for-service, discounted charges and per diem payments. Net patient service revenue is affected by the State of Connecticut Disproportionate Share program and is reported at the estimated net realizable amounts due from patients, third-party payors and others for services rendered and includes estimated retroactive revenue adjustments due to ongoing and future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations. During 2012, the Hospital recorded increases in net patient service revenue of approximately \$1,500,000 related to changes in previously estimated third party payor settlements (none in 2011).

The Hospital has established estimates based on information presently available of amounts due to or from Medicare, Medicaid and other third party payors for adjustments to current and prior year payment rates, based on industry-wide and Hospital-specific data. Such amounts are included in the accompanying consolidated balance sheets.

Patient service revenue, net of contractual allowances and before the provision for bad debts, recognized in the period from major payor sources for the year ended September 30, 2012, is as follows:

|                    |                     |
|--------------------|---------------------|
| Third-party payors | \$78,376,139        |
| Self-pay patients  | 4,470,510           |
|                    | <u>\$82,846,649</u> |

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Net Patient Service Revenue and Charity Care (continued)**

It is the policy of the Hospital to provide necessary care to all persons seeking treatment without discrimination on the grounds of age, race, creed, national origin or any other grounds unrelated to an individual's need for the service or the availability of the needed service at the Hospital. A patient is classified as a charity care patient by reference to the established policies of the Hospital. Essentially, these policies define charity care services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Hospital utilizes the generally recognized Federal poverty income guidelines, but also includes certain cases where incurred charges are significant when compared to a responsible party's income. Those charges are not included in net patient service revenue for financial reporting purposes.

The estimated cost of charity care provided was approximately \$670,900 and \$953,300 for the years ended September 30, 2012 and 2011, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital specific data.

**3. Investments and Assets Limited as to Use**

The composition of investments and funds restricted by donor, carried at fair value, is set forth in the following table:

|   | September 30        |                     |                     |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | 2012                |                     | 2011                |                     |
|   | Cost                | Fair Value          | Cost                | Fair Value          |
| Investments and funds<br>restricted by donor: |                     |                     |                     |                     |
| Cash and cash equivalents                     | \$ 1,691,858        | \$ 1,691,858        | \$ 2,027,550        | \$ 2,027,550        |
| U.S. government securities                    | 100,394             | 103,471             | 100,645             | 105,760             |
| Corporate and foreign<br>bonds                | 902,718             | 923,367             | 1,108,988           | 1,148,407           |
| Mutual funds                                  | 400,000             | 408,602             | -                   | -                   |
|   | <u>\$ 3,094,970</u> | <u>\$ 3,127,298</u> | <u>\$ 3,237,183</u> | <u>\$ 3,281,717</u> |

The current portion of assets limited as to use is comprised of \$1,200,000 of land held for sale as of September 30, 2012 and 2011.

## The New Milford Hospital, Incorporated and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **3. Investments and Assets Limited as to Use (continued)**

In 2012, the Hospital's unrestricted portion of the investment portfolio reported in the accompanying balance sheets is designated as trading, with realized and unrealized gains and losses included in the (deficiency) excess of revenues over expenses. Prior to 2012, management continually reviewed its investment portfolio and evaluated whether declines in the fair value of securities should be considered other-than-temporary as the investments were classified as other than trading securities. Factored into this evaluation were the general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of advisors and the length of time and extent to which the market value has been less than cost along with the Hospital's intent and ability to hold the investments. The Hospital held no investments in an unrealized loss position as of September 30, 2011. During the year ended September 30, 2011, the Hospital did not record any other-than-temporary declines in the fair value of investments, as the Hospital had the ability and intent to hold the securities to recovery.

Investment income included in non-operating income (loss) consists of interest and dividend income of \$429,853 and \$235,285 for the years ended September 30, 2012 and 2011, respectively.

#### **4. Fair Values of Financial Instruments**

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

The Hospital follows a valuation hierarchy that is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

*Level 1:* Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**4. Fair Values of Financial Instruments (continued)**

*Level 2:* Observable inputs that are based on inputs not quoted in active markets, but corroborated by market data.

*Level 3:* Unobservable inputs that are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

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

Financial assets carried at fair value in the accompanying consolidated balance sheets are classified in the table below in one of the three categories described above:

|   | September 30, 2012   |                     |             | Total                |
|---|----------------------|---------------------|-------------|----------------------|
|   | Level 1              | Level 2             | Level 3     |                      |
| Cash and cash equivalents                     | \$ 6,281,016         | \$ -                | \$ -        | \$ 6,281,016         |
| Investments and assets limited as to use:     |                      |                     |             |                      |
| Cash and cash equivalents                     | 1,691,858            | -                   | -           | 1,691,858            |
| U.S. government securities                    | 103,471              | -                   | -           | 103,471              |
| Corporate and foreign bonds                   | -                    | 923,367             | -           | 923,367              |
| Mutual funds:                                 |                      |                     |             |                      |
| Fixed income                                  | 408,602              | -                   | -           | 408,602              |
| Beneficial interest in trusts held by others: |                      |                     |             |                      |
| Cash and cash equivalents                     | 229,062              | -                   | -           | 229,062              |
| Mutual funds:                                 |                      |                     |             |                      |
| Domestic equity                               | 593,238              | -                   | -           | 593,238              |
| International equity                          | 284,477              | -                   | -           | 284,477              |
| Fixed income                                  | 450,929              | -                   | -           | 450,929              |
| Common collective funds:                      |                      |                     |             |                      |
| Domestic equity                               | -                    | 715,874             | -           | 715,874              |
| International equity                          | -                    | 284,417             | -           | 284,417              |
| Fixed income                                  | -                    | 583,082             | -           | 583,082              |
| Real estate/commodities                       | -                    | 462,121             | -           | 462,121              |
| Other   | -                    | 531,346             | -           | 531,346              |
|   | <u>\$ 10,042,653</u> | <u>\$ 3,500,207</u> | <u>\$ -</u> | <u>\$ 13,542,860</u> |

The above table does not include \$1,200,000 of land held for sale as of September 30, 2012 included within the current portion of assets limited as to use.

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**4. Fair Values of Financial Instruments (continued)**

|   | September 30, 2011   |                     |             | Total                |
|---|----------------------|---------------------|-------------|----------------------|
|   | Level 1              | Level 2             | Level 3     |                      |
| Cash and cash equivalents                     | \$ 12,675,086        | \$ -                | \$ -        | \$ 12,675,086        |
| Investments and assets limited as to use:     |                      |                     |             |                      |
| Cash and cash equivalents                     | 2,027,550            | -                   | -           | 2,027,550            |
| U.S. government securities                    | 105,760              | -                   | -           | 105,760              |
| Corporate and foreign bonds                   | -                    | 1,148,407           | -           | 1,148,407            |
| Beneficial interest in trusts held by others: |                      |                     |             |                      |
| Cash and cash equivalents                     | 26,573               | -                   | -           | 26,573               |
| Mutual funds:                                 |                      |                     |             |                      |
| Domestic equity                               | 1,723,021            | -                   | -           | 1,723,021            |
| International equity                          | 467,312              | -                   | -           | 467,312              |
| Fixed income                                  | 1,174,745            | -                   | -           | 1,174,745            |
| Other   | 295,190              | -                   | -           | 295,190              |
|   | <u>\$ 18,495,237</u> | <u>\$ 1,148,407</u> | <u>\$ -</u> | <u>\$ 19,643,644</u> |

The above table does not include \$1,200,000 of land held for sale as of September 30, 2011 included within the current portion of assets limited as to use.

Financial assets carried at fair value included in the defined benefit pension plan are classified in the table below in one of the three categories described above:

|                      | September 30, 2012   |             |             | Total                |
|----------------------|----------------------|-------------|-------------|----------------------|
|                      | Level 1              | Level 2     | Level 3     |                      |
| Mutual funds:        |                      |             |             |                      |
| Domestic equity      | \$ 21,149,836        | \$ -        | \$ -        | \$ 21,149,836        |
| International equity | 2,710,892            | -           | -           | 2,710,892            |
| Fixed income         | 19,859,754           | -           | -           | 19,859,754           |
| Other                | 2,713,995            | -           | -           | 2,713,995            |
|                      | <u>\$ 46,434,477</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 46,434,477</u> |

|                      | September 30, 2011   |             |             | Total                |
|----------------------|----------------------|-------------|-------------|----------------------|
|                      | Level 1              | Level 2     | Level 3     |                      |
| Mutual funds:        |                      |             |             |                      |
| Domestic equity      | \$ 12,600,394        | \$ -        | \$ -        | \$ 12,600,394        |
| International equity | 1,995,582            | -           | -           | 1,995,582            |
| Fixed income         | 21,643,729           | -           | -           | 21,643,729           |
| Other                | 2,085,655            | -           | -           | 2,085,655            |
|                      | <u>\$ 38,325,360</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 38,325,360</u> |

The New Milford Hospital, Incorporated and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**4. Fair Values of Financial Instruments (continued)**

Fair value for Level 1 assets is based upon quoted market prices. Fair value for Level 2 assets is based upon model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers and brokers.

**5. Pledges Receivable**

Pledges receivable include the following unconditional promises to give:

|  | <b>September 30</b> |             |
|--|---------------------|-------------|
|  | <b>2012</b>         | <b>2011</b> |
| Due within one year                              | <b>\$ 913,584</b>   | \$ 117,660  |
| Due within one to five years                     | <b>2,776,150</b>    | 179,400     |
|  | <b>3,689,734</b>    | 297,060     |
| Discount and allowance for uncollectible pledges | <b>(186,910)</b>    | (23,252)    |
| Present value of pledges receivable              | <b>\$ 3,502,824</b> | \$ 273,808  |

The allowance recognizes the estimated uncollectible portion of pledges and the discount of pledges at net present value. Pledges are discounted using an average rate of 3% as of September 30, 2012 and 2011.

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**6. Long-Term Debt and Capital Leases**

Long-term debt and capital lease obligations consisted of the following:

|                           | <b>September 30</b> |                     |
|---------------------------|---------------------|---------------------|
|                           | <b>2012</b>         | <b>2011</b>         |
| Term loans                | \$ 466,426          | \$ 607,285          |
| Capital lease obligations | <b>1,042,429</b>    | 1,317,206           |
|                           | <b>1,508,855</b>    | 1,924,491           |
| Less: current portion     | <b>(495,090)</b>    | (509,773)           |
|                           | <b>\$ 1,013,765</b> | <b>\$ 1,414,718</b> |

On June 11, 2010, the Hospital entered into a leasing agreement with First Litchfield Leasing Corporation to lease a 64-slice CT Scanner in the amount of \$1,008,023. Lease payments of \$56,993 are due quarterly beginning July 1, 2010 through April 1, 2015, at which point the Hospital has the option to purchase the machine for \$1. The equipment lease agreement bears interest at 1.33% quarterly. The outstanding balance of the capital lease was \$579,539 and \$820,498 as of September 30, 2012 and 2011, respectively.

On October 7, 2010, the Hospital entered into a leasing agreement with First Litchfield Leasing Corporation to lease a medical linear accelerator in the amount of \$722,405. Lease payments of \$40,845 are due quarterly beginning November 1, 2010 through August 1, 2015, at which point the Hospital has the option to purchase the machine for \$1. The equipment lease agreement bears interest at 1.33% quarterly. The outstanding balance of the capital lease was \$450,173 and \$479,893 as of September 30, 2012 and 2011, respectively.

On June 9, 2010, New Milford MRI JV, LLC entered into a loan agreement with Siemens Financial Services, Inc. in the amount of \$700,000 to help finance the construction and legal costs associated with the joint venture MRI project. Principal and interest are paid monthly in the amount of \$13,092 beginning in October 2010 through October 2015. The loan agreement bears interest at 4.63%. The outstanding balance as of September 30, 2012 and 2011 was \$439,239 and \$572,631, respectively. The carrying value of the loan approximates fair value as of September 30, 2012 and 2011.

Substantially, all assets owned by the Hospital are pledged as collateral for the term loans.

The New Milford Hospital, Incorporated and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**6. Long-Term Debt and Capital Leases (continued)**

The aggregate annual maturities of long-term debt and capital leases, net of imputed interest, for the next five fiscal years are as follows:

|  |                     |
|--|---------------------|
| Maturities of long-term debt and capital leases: |                     |
| 2013   | \$ 495,090          |
| 2014   | 521,008             |
| 2015   | 490,495             |
| 2016   | 2,262               |
|  | <u>\$ 1,508,855</u> |

Interest paid in 2012 and 2011 amounted to \$163,282 and \$61,512, respectively.

**7. Commitments and Contingencies**

**Litigation**

Malpractice claims have been asserted against the Hospital by various claimants. The claims are in various stages of processing and some may ultimately be brought to trial. In addition, the Hospital is a party to various lawsuits incidental to its business. Management believes that the claims and lawsuits will not have a material adverse effect on the Hospital's financial position.

During May 2010, the Hospital received two subpoenas from the Department of Mental Health and Human Services' Office of Inspector General (OIG) related to an investigation involving billing, coding and reimbursement of a specific drug. In November 2011, the Hospital settled the matter with the OIG. A liability for the settlement amount is recorded in due to third-party payors in the consolidated balance sheet at September 30, 2011 and was paid in 2012.

**Workers' Compensation Insurance**

The Hospital is self-insured for workers' compensation benefits. In connection with being self-insured, the Hospital has an outstanding unused letter of credit aggregating approximately \$350,000 as of September 30, 2012 and 2011. Liabilities have been accrued as of September 30, 2012 and 2011 based on expected future payments pertaining to such years.

The New Milford Hospital, Incorporated and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**7. Commitments and Contingencies (continued)**

**Operating Leases**

The Hospital leases various equipment and facilities under operating leases expiring at various dates through 2016. Total rental expense charged to operations amounted to \$738,097 and \$845,199 in 2012 and 2011, respectively.

Future minimum payments required under noncancellable operating leases with initial or remaining terms of one year or more consisted of the following as of September 30, 2012:

|                                  | <u>Operating Leases</u> |
|----------------------------------|-------------------------|
| For the year ended September 30: |                         |
| 2013                             | \$ 572,623              |
| 2014                             | 423,078                 |
| 2015                             | 346,149                 |
| 2016                             | 903                     |
| Total minimum lease payments     | <u>\$ 1,342,753</u>     |

**8. Related Party Transactions**

The Hospital has recorded amounts due to (from) related parties as follows:

|   | <u>September 30</u> |                     |
|---|---------------------|---------------------|
|   | <u>2012</u>         | <u>2011</u>         |
| Danbury Hospital                        | \$ 8,258,913        | \$ 8,315,822        |
| Western Connecticut Home Care, Inc.     | (2,344)             | -                   |
| Western Connecticut Medical Group, P.C. | <u>616,655</u>      | <u>915,495</u>      |
|   | 8,873,224           | 9,231,317           |
| Less: current portion                   | <u>(5,057,706)</u>  | <u>(4,028,167)</u>  |
|   | <u>\$ 3,815,518</u> | <u>\$ 5,203,150</u> |

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**8. Related Party Transactions (continued)**

Effective July 1, 2011, the Hospital entered into an agreement with Danbury Hospital to provide a term loan in the amount of \$6,640,229 for the payoff of the Hospital's term loans, interest rate swap, and promissory notes in June 2011. The term loan with Danbury Hospital bears interest at an annual rate of 4%. Payments of \$122,290 are due monthly beginning August 1, 2011 through July 1, 2016. The balance of the term loan was \$5,102,326 and \$6,439,583 as of September 30, 2012 and 2011, respectively. In addition, the Hospital has recorded a payable due to Danbury Hospital in the amount of \$3,156,587 and \$1,876,239 as of September 30, 2012 and 2011, respectively, for expenses, such as insurance, administrative, and other services provided by Danbury Hospital on behalf of New Milford Hospital.

**9. Pension Plans**

The Hospital has a defined benefit pension plan (the Plan) covering employees who meet certain eligibility requirements. The Plan benefits are based on years of service and the employees' compensation during the last five years of covered employment. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future. The Hospital makes contributions in amounts sufficient to meet the Employee Retirement Income Security Act of 1974 minimum funding requirements.

Effective January 31, 2010, the Hospital amended the Plan to close the Plan to new participants and to freeze accruals for all participants, other than those who were fifty-six years old and had at least ten years of service.

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Pension Plans (continued)**

The following tables set forth the changes in benefit obligations, changes in Plan assets and components of net periodic benefit cost for the Plan:

|  | <b>September 30</b>    |                        |
|--|------------------------|------------------------|
|  | <b>2012</b>            | <b>2011</b>            |
| <b>Changes in benefit obligations</b>          |                        |                        |
| Benefit obligations at beginning of year       | \$ 53,606,689          | \$ 50,247,040          |
| Service cost                                   | 279,185                | 361,224                |
| Interest cost                                  | 2,930,958              | 2,853,227              |
| Assumption changes                             | 12,459,379             | (64,119)               |
| Actuarial loss                                 | 162,932                | 2,115,608              |
| Benefits paid                                  | (2,109,106)            | (1,906,291)            |
| Benefit obligations at end of year             | <u>67,330,037</u>      | <u>53,606,689</u>      |
| <b>Changes in plan assets</b>                  |                        |                        |
| Fair value of plan assets at beginning of year | 38,325,360             | 38,307,396             |
| Actual return on plan assets                   | 6,917,318              | 1,050,373              |
| Employer contribution                          | 3,300,905              | 873,882                |
| Benefits paid                                  | (2,109,106)            | (1,906,291)            |
| Fair value of plan assets at end of year       | <u>46,434,477</u>      | <u>38,325,360</u>      |
| Underfunded status                             | <u>\$ (20,895,560)</u> | <u>\$ (15,281,329)</u> |
| <b>Components of net periodic benefit cost</b> |                        |                        |
|  | <b>2012</b>            | <b>2011</b>            |
| Service cost                                   | \$ 279,185             | \$ 361,224             |
| Interest cost                                  | 2,930,958              | 2,853,227              |
| Expected return on plan assets                 | (3,113,701)            | (3,022,986)            |
| Recognized net loss                            | 1,544,439              | 1,444,829              |
| Net periodic benefit cost                      | <u>\$ 1,640,881</u>    | <u>\$ 1,636,294</u>    |

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Pension Plans (continued)**

**Assumptions**

|   | <u>2012</u> | <u>2011</u> |
|---|-------------|-------------|
| <b>Weighted-average assumptions used to determine benefit obligations</b>       |             |             |
| Discount rate   | 4.12%       | 5.56%       |
| Rate of increase in compensation  | 3.00%       | 3.00%       |
| <b>Weighted-average assumptions used to determine net periodic benefit cost</b> |             |             |
| Discount rate   | 5.56%       | 5.55%       |
| Rate of increase in compensation  | 3.00%       | 3.00%       |
| Expected long-term return on plan assets  | 8.00%       | 8.00%       |

To develop the expected long-term rate of return on plan assets assumption, the Hospital considered the historical return and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

Amounts recorded in unrestricted net assets and not yet amortized as components of net periodic benefit costs total \$28,982,894 and \$21,708,639 as of September 30, 2012 and 2011, respectively, and represent unrecognized actuarial losses. The amortization of these components expected to be recognized in net periodic costs for the year ended September 30, 2013 is \$2,083,323.

The accumulated benefit obligation was \$66,431,677 and \$53,402,199 as of September 30, 2012 and 2011, respectively. The Plan's measurement date was September 30, 2012 and 2011.

**Plan Assets**

The Plan's investment objectives are to achieve long-term growth in excess of long-term inflation and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets over a long-term time horizon. In order to minimize the risk, the Plan aims to minimize the variability in yearly returns. The Plan also aims to diversify its holdings among sectors, industries and companies. The assets of the Plan are all held in mutual funds.

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Pension Plans (continued)**

As discussed in Note 4, the Hospital follows a three-level hierarchy to categorize assets measured at fair value. In accordance with the hierarchy, as of September 30, 2012 and 2011, 100% of the Plan assets were categorized as Level 1 investments. Securities with readily determinable values are carried at fair value as determined based on independent public sources.

**Contributions**

Management expects to contribute \$2,940,000 to the Plan during fiscal year 2013.

**Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

|                 |              |
|-----------------|--------------|
| 2013            | \$ 2,468,721 |
| 2014            | 2,719,427    |
| 2015            | 2,865,206    |
| 2016            | 3,012,808    |
| 2017            | 3,240,798    |
| Years 2018-2022 | 19,360,685   |

**Tax Sheltered Annuity**

A Tax Shelter Annuity (TSA) plan is available to substantially all employees. New participants may elect to contribute up to 20% of pretax compensation not to exceed \$16,500 in calendar year 2012 and 2011, respectively, with certain “catch-up” provisions for employees over fifty years of age. The participants are fully vested in their contributions from the date of contribution. Effective January 1, 2003, employees with hire dates after October 1, 1988 are eligible to receive a Hospital TSA matching contribution equal to 1% of their salary provided the employee deposits at least that same amount to their TSA account. This percentage increased to 2% in calendar year 2004 and to 3% beginning in calendar year 2005. In 2011, a new core contribution program was established. The TSA was frozen to new contributions as of December 31, 2011. The Hospital established a new defined contribution plan for all employees during fiscal year 2012. The expense related to the defined contribution plans was \$1,792,356 and \$1,777,328 for the years ended September 30, 2012 and 2011, respectively.

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Pension Plans (continued)**

**Supplemental Executive Retirement Plan (SERP)**

Effective December 21, 2007, the Hospital adopted a SERP under section 457(b) of the Internal Revenue Code of 1986, as amended. The Hospital adopted a second SERP, effective June 30, 2008 under section 457(f) of the Internal Revenue Code of 1986, as amended. The SERP is pursuant to the Employee Retirement Income Security Act of 1974. The SERP has been established to supplement the retirement benefits of eligible employees designated by the Hospital's Board of Directors. The accrued liability relating to the SERP amounted to \$100,798 and \$307,266 as of September 30, 2012 and 2011, respectively and is included within other accrued expenses on the consolidated balance sheets. The expenses incurred related to the SERP amounted to \$5,640 and \$17,710 for the years ended September 30, 2012 and 2011, respectively. Effective October 1, 2009, the SERP was frozen. Provisions have been made to "grandfather" those participants in the plan that are sixty years old and have at least ten years of service.

**10. Net Assets**

Temporarily restricted net assets of \$3,923,984 and \$525,763 as of September 30, 2012 and 2011, respectively, are available to the Hospital for capital expenditures. Permanently restricted net assets total \$4,134,546 and \$3,686,841 as of September 30, 2012 and 2011, respectively, are restricted funds held in trust by others, the income from which is expendable to support health care services.

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**11. Changes in Components of Working Capital Other Than Cash and Cash Equivalents**

|  | <b>Year Ended September 30</b> |                    |
|--|--------------------------------|--------------------|
|  | <b>2012</b>                    | <b>2011</b>        |
| (Increase) decrease in operating assets:                       |                                |                    |
| Pledges receivable   | \$ (3,229,016)                 | \$ 141,128         |
| Accounts receivable, net                                       | (1,269,048)                    | (2,416,246)        |
| Inventories  | 299,398                        | 99,312             |
| Prepaid expenses and other assets                              | (2,623,567)                    | 690,163            |
|  | <u>(6,822,233)</u>             | <u>(1,485,643)</u> |
| Increase (decrease) in operating liabilities:                  |                                |                    |
| Accounts payable   | (1,181,356)                    | 955,546            |
| Payroll-related accruals                                       | 873,721                        | 979,008            |
| Due to third-party payors                                      | (1,723,074)                    | 481,272            |
| Other accrued expenses   | (655,378)                      | (1,054,753)        |
| Accrued pension liabilities and other                          | 1,320,575                      | 589,948            |
|  | <u>(1,365,512)</u>             | <u>1,951,021</u>   |
| Change in working capital other than cash and cash equivalents | <u>\$ (8,187,745)</u>          | <u>\$ 465,378</u>  |

**12. Functional Expenses**

The Hospital provides healthcare services to residents within its geographic location. Expenses related to providing these services are as follows:

|                            | <b>Year Ended September 30</b> |                      |
|----------------------------|--------------------------------|----------------------|
|                            | <b>2012</b>                    | <b>2011</b>          |
| Patient care services      | \$ 59,693,994                  | \$ 63,955,500        |
| General and administrative | 25,490,979                     | 27,310,759           |
| Fundraising                | 654,269                        | 538,988              |
|                            | <u>\$ 85,839,242</u>           | <u>\$ 91,805,247</u> |

The New Milford Hospital, Incorporated and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**13. Subsequent Events**

Subsequent events have been evaluated through January 25, 2013, which represents the date the consolidated financial statements were issued. As of October 1, 2012 the New Milford Hospital Foundation, Inc. will no longer be a subsidiary of The New Milford Hospital, Incorporated as it will become part of the Western Connecticut Health Network Foundation, Inc., a subsidiary of Western Connecticut Health Network. No other events have occurred that require disclosure in or adjusted to the consolidated financial statements.

## Report of Independent Auditors on Supplementary Information

Board of Directors  
The New Milford Hospital, Incorporated and Subsidiaries

We have audited the consolidated financial statements of The New Milford Hospital, Incorporated and Subsidiaries (the Hospital) as of and for the years ended September 30, 2012, and have issued our report thereon dated January 25, 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 sheets and statements of operations are presented for the purposes of additional analysis and are 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 audits 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 consolidated 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 25, 2013

The New Milford Hospital, Incorporated and Subsidiaries

Consolidating Balance Sheets

September 30, 2012

|  | The New Milford<br>Hospital,<br>Incorporated<br>Total | New Milford<br>Hospital<br>Foundation, Inc. | Total         | Eliminations    | The New<br>Milford<br>Hospital,<br>Incorporated<br>and Subsidiaries |
|--|---|---|---------------|-----------------|---|
| <b>Assets</b>  |   |   |               |                 |   |
| Current assets:  |   |   |               |                 |   |
| Cash and cash equivalents  | \$ 3,717,748  | \$ 2,563,268                                | \$ 6,281,016  | \$ -            | \$ 6,281,016  |
| Accounts receivable, less allowance for uncollectible accounts<br>of approximately \$2,387,000 in 2012 | 8,601,320   | -   | 8,601,320     | -               | 8,601,320   |
| Current portion of assets limited as to use  | -   | 1,200,000                                   | 1,200,000     | -               | 1,200,000   |
| Current portion of pledges receivable  | -   | 900,631                                     | 900,631       | -               | 900,631   |
| Inventories  | 1,645,080   | -   | 1,645,080     | -               | 1,645,080   |
| Prepaid expenses and other   | 900,544   | -   | 900,544       | -               | 900,544   |
| Total current assets   | 14,864,692  | 4,663,899                                   | 19,528,591    | -               | 19,528,591  |
| Investments  | -   | 2,706,138                                   | 2,706,138     | -               | 2,706,138   |
| Assets limited as to use:  |   |   |               |                 |   |
| Funds restricted by donor  | -   | 421,160                                     | 421,160       | -               | 421,160   |
| Beneficial interest in trusts held by others   | -   | 4,134,546                                   | 4,134,546     | -               | 4,134,546   |
| Total noncurrent assets limited as to use  | -   | 4,555,706                                   | 4,555,706     | -               | 4,555,706   |
| Investment in New Milford Hospital Foundation  | 14,710,574  | -   | 14,710,574    | (14,710,574)    | -   |
| Other assets   | 4,358,823   | 182,638                                     | 4,541,461     | -               | 4,541,461   |
| Property, plant, and equipment:  |   |   |               |                 |   |
| Land and land improvements   | 1,544,196   | -   | 1,544,196     | -               | 1,544,196   |
| Buildings and building improvements  | 49,484,944  | -   | 49,484,944    | -               | 49,484,944  |
| Equipment and other  | 56,864,547  | -   | 56,864,547    | -               | 56,864,547  |
| Construction in progress (estimated cost to complete at<br>September 30, 2012: \$10,992,000)           | 298,414   | -   | 298,414       | -               | 298,414   |
|  | 108,192,101   | -   | 108,192,101   | -               | 108,192,101   |
| Less accumulated depreciation  | (75,751,426)  | -   | (75,751,426)  | -               | (75,751,426)  |
|  | 32,440,675  | -   | 32,440,675    | -               | 32,440,675  |
| Pledges receivable, less current portion   | -   | 2,602,193                                   | 2,602,193     | -               | 2,602,193   |
| Total assets   | \$ 66,374,764   | \$ 14,710,574                               | \$ 81,085,338 | \$ (14,710,574) | \$ 66,374,764   |
| <b>Liabilities and net assets</b>  |   |   |               |                 |   |
| Current liabilities:   |   |   |               |                 |   |
| Accounts payable   | \$ 3,081,591  | \$ -  | \$ 3,081,591  | \$ -            | \$ 3,081,591  |
| Payroll-related accruals   | 3,202,850   | -   | 3,202,850     | -               | 3,202,850   |
| Due to third-party payors  | 2,461,714   | -   | 2,461,714     | -               | 2,461,714   |
| Current portion of due to related parties  | 5,057,706   | -   | 5,057,706     | -               | 5,057,706   |
| Other accrued expenses   | 460,952   | -   | 460,952       | -               | 460,952   |
| Current portion of long-term debt and capital lease obligations  | 495,090   | -   | 495,090       | -               | 495,090   |
| Total current liabilities  | 14,759,903  | -   | 14,759,903    | -               | 14,759,903  |
| Accrued pension liabilities and other  | 26,239,675  | -   | 26,239,675    | -               | 26,239,675  |
| Due to related parties, less current portion   | 3,815,518   | -   | 3,815,518     | -               | 3,815,518   |
| Long-term debt and capital lease obligations, less current portion                                     | 1,013,765   | -   | 1,013,765     | -               | 1,013,765   |
| Net assets:  |   |   |               |                 |   |
| Unrestricted   | 12,487,373  | 6,652,044                                   | 19,139,417    | (6,652,044)     | 12,487,373  |
| Temporarily restricted   | 3,923,984   | 3,923,984                                   | 7,847,968     | (3,923,984)     | 3,923,984   |
| Permanently restricted   | 4,134,546   | 4,134,546                                   | 8,269,092     | (4,134,546)     | 4,134,546   |
| Total net assets   | 20,545,903  | 14,710,574                                  | 35,256,477    | (14,710,574)    | 20,545,903  |
| Total liabilities and net assets   | \$ 66,374,764   | \$ 14,710,574                               | \$ 81,085,338 | \$ (14,710,574) | \$ 66,374,764   |

The New Milford Hospital, Incorporated and Subsidiaries

Consolidating Balance Sheets

September 30, 2011

|  | The New<br>Milford<br>Hospital,<br>Incorporated<br>Total | New Milford<br>Hospital<br>Foundation,<br>Inc. | Total         | Eliminations    | The New<br>Milford<br>Hospital,<br>Incorporated<br>and Subsidiaries |
|--|--|--|---------------|-----------------|---|
| <b>Assets</b>  |  |  |               |                 |   |
| Current assets:  |  |  |               |                 |   |
| Cash and cash equivalents  | \$ 10,710,102  | \$ 1,964,984                                   | \$ 12,675,086 | \$ -            | \$ 12,675,086   |
| Accounts receivable, less allowance for uncollectible accounts<br>of approximately \$2,311,000 in 2011 | 10,457,444   | -  | 10,457,444    | -               | 10,457,444  |
| Current portion of assets limited as to use  | -  | 1,200,000                                      | 1,200,000     | -               | 1,200,000   |
| Current portion of pledges receivable  | -  | 117,660  | 117,660       | -               | 117,660   |
| Inventories  | 1,944,478  | -  | 1,944,478     | -               | 1,944,478   |
| Prepaid expenses and other   | 1,415,038  | 567  | 1,415,605     | -               | 1,415,605   |
| Total current assets   | 24,527,062   | 3,283,211                                      | 27,810,273    | -               | 27,810,273  |
| Investments  | 199,742  | 2,556,212                                      | 2,755,954     | -               | 2,755,954   |
| Assets limited as to use:  |  |  |               |                 |   |
| Funds restricted by donor  | -  | 525,763  | 525,763       | -               | 525,763   |
| Beneficial interest in trusts held by others   | -  | 3,686,841                                      | 3,686,841     | -               | 3,686,841   |
| Total noncurrent assets limited as to use  | -  | 4,212,604                                      | 4,212,604     | -               | 4,212,604   |
| Investment in New Milford Hospital Foundation  | 10,110,186   | -  | 10,110,186    | (10,110,186)    | -   |
| Other assets   | 1,402,833  | -  | 1,402,833     | -               | 1,402,833   |
| Property, plant, and equipment:  |  |  |               |                 |   |
| Land and land improvements   | 1,546,857  | -  | 1,546,857     | -               | 1,546,857   |
| Buildings and building improvements  | 50,072,773   | 105,563  | 50,178,336    | -               | 50,178,336  |
| Equipment and other  | 54,763,793   | -  | 54,763,793    | -               | 54,763,793  |
|  | 106,383,423  | 105,563  | 106,488,986   | -               | 106,488,986   |
| Less accumulated depreciation  | (71,638,392)   | (105,563)                                      | (71,743,955)  | -               | (71,743,955)  |
|  | 34,745,031   | -  | 34,745,031    | -               | 34,745,031  |
| Pledges receivable, less current portion   | -  | 156,148  | 156,148       | -               | 156,148   |
| Total assets   | \$ 70,984,854  | \$ 10,208,175                                  | \$ 81,193,029 | \$ (10,110,186) | \$ 71,082,843   |
| <b>Liabilities and net assets</b>  |  |  |               |                 |   |
| Current liabilities:   |  |  |               |                 |   |
| Accounts payable   | \$ 4,235,702   | \$ 27,245                                      | \$ 4,262,947  | \$ -            | \$ 4,262,947  |
| Payroll-related accruals   | 2,329,129  | -  | 2,329,129     | -               | 2,329,129   |
| Due to third-party payors  | 4,184,788  | -  | 4,184,788     | -               | 4,184,788   |
| Current portion of due to related parties  | 3,957,423  | 70,744   | 4,028,167     | -               | 4,028,167   |
| Other accrued expenses   | 1,116,330  | -  | 1,116,330     | -               | 1,116,330   |
| Current portion of long-term debt and capital lease obligation   | 509,773  | -  | 509,773       | -               | 509,773   |
| Total current liabilities  | 16,333,145   | 97,989   | 16,431,134    | -               | 16,431,134  |
| Accrued pension liabilities and other  | 17,644,845   | -  | 17,644,845    | -               | 17,644,845  |
| Due to related parties, less current portion   | 5,203,150  | -  | 5,203,150     | -               | 5,203,150   |
| Long-term debt and capital lease obligation, less current portion                                      | 1,414,718  | -  | 1,414,718     | -               | 1,414,718   |
| Net assets:  |  |  |               |                 |   |
| Unrestricted   | 26,176,392   | 5,897,582                                      | 32,073,974    | (5,897,582)     | 26,176,392  |
| Temporarily restricted   | 525,763  | 525,763  | 1,051,526     | (525,763)       | 525,763   |
| Permanently restricted   | 3,686,841  | 3,686,841                                      | 7,373,682     | (3,686,841)     | 3,686,841   |
| Total net assets   | 30,388,996   | 10,110,186                                     | 40,499,182    | (10,110,186)    | 30,388,996  |
| Total liabilities and net assets   | \$ 70,984,854  | \$ 10,208,175                                  | \$ 81,193,029 | \$ (10,110,186) | \$ 71,082,843   |

The New Milford Hospital, Incorporated and Subsidiaries

Consolidating Statements of Operations

Year Ended September 30, 2012

|  | The New<br>Milford<br>Hospital,<br>Incorporated<br>Total | New Milford<br>Hospital<br>Foundation,<br>Inc. | Total          | Eliminations | The New<br>Milford<br>Hospital,<br>Incorporated<br>and Subsidiaries |
|--|--|--|----------------|--------------|---|
| Unrestricted revenues:   |  |  |                |              |   |
| Net patient service revenue  | \$ 81,236,073  | \$ -   | \$ 81,236,073  | \$ -         | \$ 81,236,073   |
| Provision for bad debt   | 3,125,172  |  | 3,125,172      |              | 3,125,172   |
| Net patient service revenue less provision for bad debt                | 78,110,901   | -  | 78,110,901     | -            | 78,110,901  |
| Net assets released from restriction                                   | 66,843   | -  | 66,843         | -            | 66,843  |
| Other operating revenue  | 1,034,489  | -  | 1,034,489      | -            | 1,034,489   |
|  | 79,212,233   | -  | 79,212,233     | -            | 79,212,233  |
| Expenses:  |  |  |                |              |   |
| Salaries, benefits and fees  | 51,817,496   | -  | 51,817,496     | -            | 51,817,496  |
| Supplies and other   | 25,778,114   | -  | 25,778,114     | -            | 25,778,114  |
| Insurance  | 1,643,424  | -  | 1,643,424      | -            | 1,643,424   |
| Depreciation and amortization  | 5,526,925  | -  | 5,526,925      | -            | 5,526,925   |
| Interest   | 419,014  | -  | 419,014        | -            | 419,014   |
| Loss from operations   | 85,184,973   | -  | 85,184,973     | -            | 85,184,973  |
|  | (5,972,740)  | -  | (5,972,740)    | -            | (5,972,740)   |
| Nonoperating income (loss):  |  |  |                |              |   |
| Contributions  | (5,250)  | 1,014,327                                      | 1,009,077      | -            | 1,009,077   |
| Investment income, net   | 23,243   | 406,610  | 429,853        | -            | 429,853   |
| Change in unrealized gains and losses on investments                   | -  | (12,206)                                       | (12,206)       | -            | (12,206)  |
| Operating expenses of the New Milford Hospital Foundation              | -  | (654,269)                                      | (654,269)      | -            | (654,269)   |
| Change in the Equity Interest of New Milford Hospital Foundation, Inc. | 754,462  | -  | 754,462        | (754,462)    | -   |
|  | 772,455  | 754,462  | 1,526,917      | (754,462)    | 772,455   |
| (Deficiency) excess of revenues over expenses                          | \$ (5,200,285)   | \$ 754,462                                     | \$ (4,445,823) | \$ (754,462) | \$ (5,200,285)  |

The New Milford Hospital, Incorporated and Subsidiaries

Consolidating Statements of Operations

Year Ended September 30, 2011

|  | The New<br>Milford<br>Hospital,<br>Incorporated<br>Total | New Milford<br>Hospital<br>Foundation,<br>Inc. | Total         | Eliminations | The New<br>Milford<br>Hospital,<br>Incorporated<br>and Subsidiaries |
|--|--|--|---------------|--------------|---|
| Unrestricted revenues:   |  |  |               |              |   |
| Net patient service revenue  | \$ 90,588,107  | \$ -   | \$ 90,588,107 | \$ -         | \$ 90,588,107   |
| Provision for bad debt   | 2,545,989  | -  | 2,545,989     | -            | 2,545,989   |
| Net patient service revenue less provision for bad debt            | 88,042,118   | -  | 88,042,118    | -            | 88,042,118  |
| Net assets released from restriction                               | 346,393  | -  | 346,393       | (141,720)    | 204,673   |
| Other operating revenue  | 2,623,754  | -  | 2,623,754     | -            | 2,623,754   |
|  | 91,012,265   | -  | 91,012,265    | (141,720)    | 90,870,545  |
| Expenses:  |  |  |               |              |   |
| Salaries, benefits and fees  |  |  |               |              |   |
| Supplies and other   | 53,344,078   | -  | 53,344,078    | -            | 53,344,078  |
| Insurance  | 29,943,627   | -  | 29,943,627    | -            | 29,943,627  |
| Depreciation and amortization                                      | 1,611,492  | -  | 1,611,492     | -            | 1,611,492   |
| Interest   | 5,855,136  | -  | 5,855,136     | -            | 5,855,136   |
|  | 511,926  | -  | 511,926       | -            | 511,926   |
| Loss from operations   | 91,266,259   | -  | 91,266,259    | -            | 91,266,259  |
|  | (253,994)  | -  | (253,994)     | (141,720)    | (395,714)   |
| Nonoperating income (loss):  |  |  |               |              |   |
| Contributions  |  |  |               |              |   |
| Investment income, net   | -  | 1,536,643                                      | 1,536,643     | -            | 1,536,643   |
| Operating expenses of the New Milford Hospital<br>Foundation, Inc. | 64,299   | 170,986  | 235,285       | -            | 235,285   |
|  | -  | (680,708)                                      | (680,708)     | 141,720      | (538,988)   |
| Deficiency (excess) of revenues over expenses                      | 64,299   | 1,026,921                                      | 1,091,220     | 141,720      | 1,232,940   |
|  | \$ (189,695)   | \$ 1,026,921                                   | \$ 837,226    | \$ -         | \$ 837,226  |

Ernst & Young LLP

Assurance | Tax | Transactions | Advisory

**About Ernst & Young**

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 167,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

For more information, please visit [www.ey.com](http://www.ey.com)

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. This Report has been prepared by Ernst & Young LLP, a client serving member firm located in the United States.

