

# The Rockville General Hospital, Inc.

Independent Auditors' Report and  
Financial Statements

As of and for the Years Ended  
September 30, 2012 and 2011



Saslow Lufkin & Buggy, LLP  
*Certified Public Accountants and Consultants*

**The Rockville General Hospital, Inc.**  
**Independent Auditors' Report and Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

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Independent Auditors' Report

To the Board of Trustees of  
The Rockville General Hospital, Inc.:

We have audited the accompanying balance sheets of The Rockville General Hospital, Inc. (the Hospital) (a subsidiary of Eastern Connecticut Health Network, Inc.), as of September 30, 2012 and 2011, and the related statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

*Saslow Lufkin & Buggy, LLP*

December 18, 2012

**The Rockville General Hospital, Inc.**  
**Balance Sheets**  
**September 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,463,823	\$ 4,739,454
Current portion of assets whose use is limited	467,222	501,284
Accounts receivable, less allowance for bad debts of \$2,265,004 in 2012 and \$1,327,058 in 2011	10,959,585	10,246,785
Inventory	1,519,666	1,576,966
Due from affiliates	781,899	2,196,771
Current portion of estimated settlements due from third-party payers	853,555	-
Prepaid expenses and other current assets	218,802	270,651
Total current assets	16,264,552	19,531,911
Assets whose use is limited - net of current portion:		
Donor restricted investments	1,696,049	2,018,549
Board designated investments	9,011,067	7,095,031
Investments held under bond indentures	931,963	1,890,523
Beneficial interest in trust assets	2,104,303	1,887,242
Total assets whose use is limited - net of current portion	13,743,382	12,891,345
Interest in net assets of ECHN Community Healthcare Foundation, Inc.	3,254,582	2,629,614
Investments in joint ventures	3,127,553	2,858,713
Property, plant and equipment, net	30,472,774	31,151,854
Investments	9,554,311	7,740,794
Other assets:		
Estimated settlements due from third-party payers	-	1,856,415
Due from affiliated entities - net of current portion	2,620,000	4,058,961
Intangible assets - net	-	72,000
Other - net	831,619	866,926
Total other assets	3,451,619	6,854,302
Total assets	\$ 79,868,773	\$ 83,658,533
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 5,969,615	\$ 4,898,568
Current portion of long-term debt and capital lease obligations	1,271,671	1,247,313
Due to affiliated entities	3,297,172	2,717,350
Estimated settlements due to third-party payers	1,157,913	684,512
Current portion of accrued pension and other postretirement benefits	1,164,039	2,650,753
Other current liabilities	715,430	1,240,661
Total current liabilities	13,575,840	13,439,157
Long-term debt and capital lease obligations - net of current portion	24,394,084	25,860,313
Estimated self-insurance liabilities	3,307,458	1,813,842
Accrued pension and other postretirement benefits - net of current portion	17,147,802	13,402,108
Other liabilities	128,578	125,749
Total liabilities	58,553,762	54,641,169
Net assets:		
Unrestricted	17,066,097	24,688,727
Temporarily restricted	615,748	912,532
Permanently restricted	3,633,166	3,416,105
Total net assets	21,315,011	29,017,364
Total liabilities and net assets	\$ 79,868,773	\$ 83,658,533

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

**The Rockville General Hospital, Inc.**  
**Statements of Operations and Changes in Net Assets**  
**For the Years Ended September 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Revenues:</b>		
Net patient service revenue	\$ 67,847,638	\$ 63,387,116
Change in interest in unrestricted net assets of ECHN Community Healthcare Foundation, Inc.	192,851	237,954
Other revenues	5,020,030	3,888,629
EHR incentive payment revenue	1,626,870	618,428
Net assets released from restrictions used for operations	31,857	48,044
Total revenues	74,719,246	68,180,171
<b>Expenses:</b>		
Salaries and wages	30,268,391	29,535,778
Fringe benefits	10,042,713	8,838,640
Supplies and other	25,886,843	21,930,029
Provision for bad debts	3,309,948	2,925,278
Depreciation and amortization	3,811,952	3,672,297
Interest and financing costs	719,107	1,115,177
Total expenses	74,038,954	68,017,199
Income from operations	680,292	162,972
Non-operating losses	(179,961)	(855,256)
Excess (deficiency) of revenues over expenses	\$ 500,331	\$ (692,284)

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

**The Rockville General Hospital, Inc.**  
**Statements of Operations and Changes in Net Assets (continued)**  
**For the Years Ended September 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
Unrestricted net assets:		
Excess (deficiency) of revenues over expenses	\$ 500,331	(692,284)
Change in unrealized appreciation (depreciation) on investments	2,852,929	(611,526)
Net change on interest rate swap agreement	-	1,509,597
Equity transfer to ECHN	(8,205,356)	(8,575,553)
Transfer of WCW net assets to RGH	-	1,740,285
Transfers from other affiliated entities	424,971	6,790
Change in investment of ECHN Community Healthcare Foundation, Inc.	560,369	(347,084)
Net assets released from restrictions used for capital	48,524	1,132,631
Pension and postretirement-related adjustments	(3,804,398)	(3,218,413)
Change in unrestricted net assets	(7,622,630)	(9,055,557)
Temporarily restricted net assets:		
Change in interest in net assets of ECHN Community Healthcare Foundation, Inc.	54,835	55,652
Change in unrealized appreciation (depreciation) on investments	119,637	(62,933)
Investment income	18,801	9,785
Net assets released from restrictions for operations	(31,857)	(48,044)
Net assets released from restrictions used for capital	(48,524)	(1,132,631)
Transfer of WCW net assets to RGH	-	24,082
Transfers (to) from ECHN and other affiliates	(409,676)	633,488
Change in temporarily restricted net assets	(296,784)	(520,601)
Permanently restricted net assets:		
Change in beneficial interest in trust assets	217,061	(71,109)
Change in permanently restricted net assets	217,061	(71,109)
Change in net assets	(7,702,353)	(9,647,267)
Net assets at beginning of year	29,017,364	38,664,631
Net assets at end of year	\$ 21,315,011	\$ 29,017,364

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

**The Rockville General Hospital, Inc.**  
**Statements of Cash Flows**  
**For the Years Ended September 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
Cash flows from operating activities:		
Change in net assets	\$ (7,702,353)	\$ (9,647,267)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	3,811,952	3,672,297
Amortization of bond costs related to Series B defeasement	-	390,236
Provision for bad debts	3,309,948	2,925,278
Change in unrealized (appreciation) depreciation on investments	(3,092,203)	611,526
(Income) loss on investments in joint venture	(268,841)	31,113
Transfers to other affiliated entities	8,190,061	6,170,908
Change in interest in net assets of ECHN Community Healthcare Foundation, Inc.	(624,968)	44,252
Change in beneficial interest in trust assets	(217,061)	71,109
Pensions and postretirement-related adjustments	3,804,398	3,218,413
Net change on interest rate swap	-	(1,047,460)
Changes in assets and liabilities:		
Accounts receivable	(4,022,748)	(3,507,173)
Inventory	57,300	(77,788)
Prepaid expenses and other current assets	51,849	(40,710)
Estimated settlements due to/from third-party payers	1,476,261	61,872
Due (from) to affiliates	2,992,557	5,754,249
Intangible assets - net	72,000	108,000
Other - net	(9,986)	55,767
Accounts payable and accrued expenses	545,816	689,138
Accrued pension and other postretirement benefits	(1,545,418)	(952,851)
Estimated self-insurance liabilities	1,493,616	(25,188)
Other liabilities	2,829	733,532
Net cash provided by operating activities	<b>8,325,009</b>	<b>9,239,253</b>
Cash flows from investing activities:		
Purchases of property and equipment	(1,728,554)	(2,020,432)
Purchases of investments, net	(1,352,726)	(3,018,939)
Distributions from joint ventures	-	(35,000)
Proceeds from sales of investments and assets whose use is limited	1,988,371	1,071,513
Net cash used in investing activities	<b>(1,092,909)</b>	<b>(4,002,858)</b>
Cash flows from financing activities:		
Principal payments on long-term debt	(2,317,670)	(16,920,114)
Payments for bond issuance costs	-	(639,258)
Payment for termination of interest rate swaps	-	(1,380,804)
Proceeds from issuance of long-term debt	-	18,776,732
Transfers to other affiliated entities	(8,190,061)	(6,170,908)
Net cash used in financing activities	<b>(10,507,731)</b>	<b>(6,334,352)</b>
Change in cash and cash equivalents	<b>(3,275,631)</b>	<b>(1,097,957)</b>
Cash and cash equivalents at beginning of year	<b>4,739,454</b>	<b>5,837,411</b>
Cash and cash equivalents at end of year	<b>\$ 1,463,823</b>	<b>\$ 4,739,454</b>
Cash paid for interest	<b>\$ 824,710</b>	<b>\$ 1,038,142</b>
Equipment acquisitions under capital lease arrangements	<b>\$ 875,799</b>	<b>\$ 646,232</b>

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

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 1 - General**

The Rockville General Hospital, Inc. (the Hospital or RGH) is a not-for-profit, 102-bed acute care hospital that provides inpatient, outpatient and emergency care services for residents of Vernon-Rockville and surrounding towns. The Hospital is a subsidiary of the Eastern Connecticut Health Network, Inc. (ECHN or the Network), which was formed in 1995 by a merger of MMH Corp. and Rockville Area Health Services, Inc. ECHN was organized to provide a broader health care system for the surrounding communities with quality medical care at a reasonable cost and to foster an environment conducive to health and well-being whether in the home or in the community.

Other related entities of RGH include:

***The Manchester Memorial Hospital (MMH)*** - MMH is a not-for-profit hospital with 249 licensed beds, located in Manchester, Connecticut. MMH, which admitted its first patient in 1920, is a short-term, acute care general hospital, which provides inpatient, outpatient, and emergency care services to the residents of Manchester and 19 nearby towns.

***ECHN ElderCare Services, Inc. (EES)*** - EES is a not-for-profit skilled nursing facility with 130 licensed beds and physical, occupational, and speech rehabilitation services located in Tolland, Connecticut.

***ECHN Community Healthcare Foundation, Inc. (ECHF)*** - ECHF is a not-for-profit organization whose purpose is to raise funds on behalf of ECHN and its not-for-profit subsidiaries. It was established in 2000, when the fundraising efforts of ECHN were consolidated into a single not-for-profit foundation. ECHF focuses primarily on the capital and program needs of ECHN and its not-for-profit subsidiaries.

***Eastern Connecticut Medical Professionals Foundation, Inc. (ECMPF)*** - ECMPF is a not-for-profit organization that currently operates physician office practices in the Network's service area and a hospitalist program that serves MMH and RGH. Its mission allows it to operate other not-for-profit, separately incorporated allied health ventures.

***ECHN Enterprises, Inc. (Enterprises)*** - Enterprises is a for-profit organization formed under the laws of the State of Connecticut, with ECHN as the sole shareholder. Enterprises owns, leases and has an interest in real estate to support the mission and vision of ECHN. It is also the parent corporation of Haynes Street Property Management, LLC (HSPM). HSPM is a for-profit limited liability company formed under the laws of the State of Connecticut, which manages the Glastonbury Wellness Center and sublets space to various MMH departments and physician offices, as well as to ECMPF.

***Connecticut Healthcare Insurance Company (CHIC)*** - CHIC, a captive insurance company, provides hospital and physician professional and general liability coverage to MMH, RGH, EES, and all other subsidiaries of ECHN.

***Visiting Nurse and Health Services of Connecticut (VNHSC)*** - VNHSC is a not-for-profit, nonstock Connecticut corporation that provides and administers a comprehensive, multi-disciplinary home health program, hospice program and wellness programs to promote the health of individuals, families and groups in the Greater Northern Central Connecticut area. In addition, VNHSC is the sole member of A Caring Hand, LLC, which is a for-profit Connecticut limited liability company providing and administering homemaker, companion, live-in and personal care assistance services to individuals and families in the Greater Northern Central Connecticut area.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 1 - General (continued)**

ECHN and each of its subsidiaries, except for Enterprises, CHIC and A Caring Hand, LLC, are separate Connecticut not-for-profit corporations, qualified as exempt organizations under Section 501(c)(3) of the Internal Revenue Code (IRC) and governed by separate Boards of Trustees (the Board) - although the membership of the ECHN, MMH, and RGH boards are currently identical. ECHN, acting through its Board of Trustees, is the sole member of each of its subsidiaries.

ECHN has various powers with regard to each of its members, which include approving all operating and capital budgets; controlling the investment of funds, location of services, agreements and transactions, affiliations, controlling changes, amendments or restatements of certificates of incorporation and bylaws, electing trustees and officers, appointing committees, adopting a system-wide vision and strategic plans and approving debt borrowings.

**Note 2 - Summary of Significant Accounting Policies**

**Basis of Presentation** - The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), as promulgated by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC).

**Use of Estimates** - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Hospital's significant estimates relate to the valuation of investments and interest rate swap agreements, allowance for doubtful patient accounts receivable, contractual allowances on patient accounts receivable, self-insurance liabilities, estimated settlements due to and from third parties, conditional asset retirement obligations, postretirement and pension benefit costs and the related obligations.

**Cash and Cash Equivalents** - The Hospital considers all highly liquid investments with original maturities of three months or less at date of purchase to be cash equivalents, excluding amounts whose use is limited or restricted by Board designation or other arrangements under trust agreements. Cash equivalents include money market funds. In general, the Federal Deposit Insurance Corporation (FDIC) insures cash balance up to \$250,000 per depositor, per bank. The FDIC also provides separate unlimited coverage for deposit accounts that meet the definition of non-interest bearing accounts. Unlimited coverage on non-interest bearing accounts extends until December 31, 2012. At times, the Hospital maintains cash balances that are in excess of the insured FDIC limits. The Hospital maintains its cash at various banks and it is the Hospital's policy to monitor the financial strength of the banks on an ongoing basis.

Money market funds are not insured by the FDIC and are not a risk-free investment. Money market funds invest in a variety of instruments including mortgage-backed and asset-backed securities. Although a money market fund seeks to preserve its \$1 per share value, it is possible that a money market fund's value can decrease below \$1 per share.

**Net Assets** - Resources are reported for accounting purposes in separate classes of net assets based on the existence or absence of donor-imposed restrictions. In the accompanying financial statements, net assets that have similar characteristics have been combined as follows:

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

***Permanently Restricted*** - Net assets subject to explicit donor-imposed stipulations that they be maintained by the Hospital in perpetuity are classified as permanently restricted. Such permanently restricted assets include endowment funds and the Hospital's share of its beneficial interest in trust assets held by third parties. Generally, the donors of these assets permit the Hospital to use all or part of the investment return on these assets for operating purposes.

***Temporarily Restricted*** - Net assets whose use by the Hospital is subject to explicit donor-imposed stipulations that can be fulfilled upon incurrence of expenditures by the Hospital pursuant to those stipulations or that expire by the passage of time are classified as temporarily restricted.

***Unrestricted*** - Net assets that are not subject to explicit donor-imposed stipulations are classified as unrestricted. Unrestricted net assets may be designated for specific purposes by action of the Board or may otherwise be limited by contractual agreements with outside parties. Such designated assets are classified as assets whose use is limited in the accompanying balance sheets.

Revenues are reported as increases in unrestricted net assets, unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets, unless their use is restricted by explicit donor stipulations or by law.

Expirations of temporary restrictions on net assets, that is, the donor-imposed stipulated purpose has been accomplished and/or stipulated period has elapsed, are reported as reclassifications between the applicable classes of net assets.

Contributions, including unconditional promises to give, are recognized as revenues at the date the promise is received. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year are discounted at the appropriate rate commensurate with the risks involved. Amortization of the discount is included in other revenues. Contributions restricted for the acquisition of land, buildings and equipment are reported as temporarily restricted support. These contributions are reclassified to unrestricted net assets when the capital asset is acquired or constructed and placed in service.

***Assets Whose Use is Limited*** - Assets whose use is limited primarily include cash and investments held by trustees under indenture agreements, Board designated investments which include endowments and cash and investments set aside by the Board for future capital improvements over which the Board retains control and may, at its discretion, subsequently use for other purposes, beneficial interests in trust assets, donor restricted and other restricted investments. Amounts required to meet current liabilities of the Hospital have been classified as current assets in the balance sheets as of September 30, 2012 and 2011.

The income earned on restricted funds is generally available for operations of the Hospital and is recorded as revenue in unrestricted net assets, unless restricted by the donor or to pay future split interest obligations, at which time the income is added to the appropriate restricted net asset balance. However, if a specific gift instrument explicitly requires the permanent reinvestment of appreciation, or a portion thereof, such reinvested amounts are recorded within permanently restricted net assets. There were no gifts with reinvestment restrictions for the years ended September 30, 2012 and 2011.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

The Hospital relies on a balanced strategy in which endowment returns are achieved through both capital appreciation and interest and dividends. The Hospital targets a diversified asset allocation of fixed income mutual funds, fixed income equity funds and money market funds.

Assets received as donations or bequests are recorded as contributions on the date received at the estimated fair value. The average cost method is used to determine realized gains or losses on sales of marketable equity securities.

**Beneficial Interest in Trust Assets** - RGH has been named sole or participating beneficiary in several perpetual trusts, for which third parties act as the trustee. Under the terms of these trusts, RGH has the irrevocable right to receive the income earned on the trust assets in perpetuity. The estimated present value of the future payments to RGH is recorded at the fair value of the assets held in the trust as beneficial interest in trust assets and is classified as permanently restricted.

The income from the trusts is included in the change in interest in unrestricted net assets of ECHF as unrestricted and temporarily restricted support. For the years ended September 30, 2012 and 2011, income of \$93,826 and \$72,563, respectively, was recorded in the statements of operations and changes in net assets. Changes in the fair value of the trust assets are recognized as changes in permanently restricted net assets. RGH records the beneficial interest in trust assets when it is notified of the existence of the trust or when information becomes available to record the fair value of the trust assets.

**Investments** - The Hospital's investment portfolio is classified as available for sale, with unrealized gains and losses excluded from the excess of revenues over expenses, unless the losses are deemed to be other than temporary. Investments in equity securities with readily determinable fair values and all investments in mutual funds are measured at fair value in the balance sheets.

Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses, unless the income or loss is restricted by donor or law.

**Other Than Temporary Impairments on Investments** - The Hospital accounts for other than temporary impairments in accordance with FASB ASC 320 and continually reviews its securities for impairment conditions, which could indicate that an other than temporary decline in market value has occurred. In conducting this review, numerous factors are considered, which include specific information pertaining to an individual company or a particular industry, general market conditions that reflect prospects for the economy as a whole and the ability and intent to hold securities until recovery. The carrying value of investments is reduced to its estimated realizable value if a decline in fair value is considered to be other than temporary. The Hospital has recorded an impairment charge of \$0 and \$22,832 for the years ended September 30, 2012 and 2011, respectively, related to investments held by CHIC.

**Property, Plant and Equipment** - Property, plant and equipment are stated at cost or, in the case of donated property, at fair value at the date of the gift, less accumulated depreciation and amortization. Major improvements and betterments to existing plant and equipment are capitalized. Expenditures for maintenance and repairs, which do not extend the lives of the applicable assets, are charged to expense as incurred. Upon disposition or retirement of property, plant and equipment, the cost and related accumulated depreciation and amortization are eliminated from the respective accounts and any resulting gain or loss is included in the results of operations.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

Depreciation expense is computed on a straight-line basis over the estimated useful lives as follows:

Buildings	10 - 40 years
Building improvements	5 - 40 years
Machinery and equipment	3 - 15 years
Furniture and fixtures	5 - 20 years

Equipment under capital leases is amortized utilizing the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Depreciation and amortization expense was \$3,724,532 and \$3,570,884 for the years ended September 30, 2012 and 2011, respectively.

Interest cost incurred on borrowed funds during the construction period of capital assets is capitalized as a component of the cost of acquiring those assets.

Physician loan amortization totaling \$42,127 and \$57,525 as of September 30, 2012 and 2011, respectively, is included within depreciation and amortization in the accompanying statements of operations and changes in net assets.

Gifts of property and equipment are reported as unrestricted support and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used.

Gifts of property and equipment with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire property and equipment are reported as restricted support. Absent explicit donor stipulations about how long those property, plant and equipment must be maintained, expirations of donor restrictions are reported as released from restrictions when the donated or acquired property, plant and equipment assets are placed in service.

**Investments in Joint Ventures** - The Hospital has invested in joint ventures, which are accounted for under the equity method of accounting. These joint ventures, as of September 30, 2012 and 2011, include the Hospital's investment in the following:

	<u>2012</u>	<u>Ownership Percentage</u>	<u>2011</u>	<u>Ownership Percentage</u>
Northeast Regional Radiation Oncology Network, Inc.	\$ 3,055,158	25%	\$ 2,819,068	25%
Tolland Imaging Center	72,395	35%	39,645	35%
	<u>\$ 3,127,553</u>		<u>\$ 2,858,713</u>	

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

There were no distributions received from these joint ventures in 2012 and 2011. The Hospital's share of the earnings or losses of the joint ventures are reported within other revenues and are \$268,841 and (\$31,113) for the years ended September 30, 2012 and 2011, respectively.

Summarized financial information from the financial statements of these organizations as of September 30, 2012 and 2011, and for the years then ended, is as follows:

<u>2012</u>	<u>Total Assets</u>	<u>Net Assets</u>	<u>Change in Net Assets</u>	<u>Excess of Revenues Over Expenses</u>
Northeast Regional Radiation				
Oncology Network, Inc.	\$ 12,257,336	\$ 12,220,632	\$ 944,362	\$ 961,990
Tolland Imaging Center	\$ 1,258,554	\$ 214,706	\$ 101,436	\$ 100,840
<u>2011</u>	<u>Total Assets</u>	<u>Net Assets</u>	<u>Change in Net Assets</u>	<u>Deficiency of Revenues Over Expenses</u>
Northeast Regional Radiation				
Oncology Network, Inc.	\$ 14,987,787	\$ 11,276,270	\$ (24,696)	\$ (24,809)
Tolland Imaging Center	\$ 1,696,739	\$ 113,270	\$ 28,745	\$ (52,019)

**Unamortized Bond Issue Costs** - Financing costs associated with the issuance of long-term debt are amortized over the term of the bonds using the effective interest method. Amortization is included in depreciation and amortization costs in the accompanying statements of operations and changes in net assets and the unamortized carrying value is recorded within other - net in the accompanying balance sheets.

**Intangible Assets** - Intangible assets, principally license enhancements, are amortized over the life of the respective intangible property. On average, this amortization period for license enhancements is 5 years. Amortization is included in depreciation and amortization in the accompanying statements of operations and changes in net assets and the unamortized carrying value is recorded within intangible assets - net in the accompanying balance sheets. Any residual value remaining after the amortization period is considered insignificant.

**Excess (Deficiency) of Revenues Over Expenses** - The statements of operations and changes in net assets include the excess (deficiency) of revenues over expenses. Changes in unrestricted net assets, which are excluded from the excess (deficiency) of revenues over expenses, consistent with industry practice, include changes in unrealized appreciation (depreciation) on investments, net loss on interest rate swap that qualifies for hedge accounting; net assets released from restrictions used for capital acquisitions; pension and postretirement-related adjustments; transfers to and from affiliates.

For purposes of display, transactions deemed by management to be ongoing, major or central to providing of health care services are reported as operating revenues and operating expenses. Operating revenues include net patient service revenue, grant income and investment income. Peripheral or incidental transactions are reported as non-operating gains, losses and expenses.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

Non-operating gains and losses include investment income and expenses related to property management, realized gains and losses on sales of investments, losses recognized on investments representing declines in value considered to be other-than-temporary in nature, gains and losses related to the termination of certain swap instruments, changes in the fair values of interest rate swaps that do not qualify for hedge accounting (net interest expense) and the costs associated with pursuing business combinations.

**Charity Care** - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established and contractual rates. The Hospital does not pursue collection of amounts determined to qualify as charity care; as such, these amounts are not reported as revenue.

**Deferred Revenue** - Deferred revenue represents payments received for the services to be rendered in the next fiscal year and is recorded within other current liabilities in the accompanying balance sheets.

**Net Patient Service Revenue** - Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. 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.

Contracts, laws and regulations governing Medicare, Medicaid, Blue Cross and the uncompensated care pool programs in the State of Connecticut are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Hospital records adjustments to the amounts accrued for estimated settlements related to prior years.

A portion of the accrual for estimated settlements with third-party payers has been classified as long term because such amounts, by their nature or by virtue of regulation or legislation, are not expected to be paid within one year.

The Hospital has agreements with third-party payers that provide for payments at amounts different from its established rates. A summary of the payment agreements with major third-party payers is as follows:

**Medicare** - Acute care hospitals are subject to a federal prospective payment system for most Medicare inpatient hospital services and for certain outpatient services. Under this prospective payment methodology, Medicare pays a prospectively determined per discharge or per visit rate for non-physician services. These rates vary according to the Diagnosis-Related Group or Ambulatory Payment Classification of each patient.

Inpatient rehabilitation and mental health services, outpatient services, capital and medical education costs related to Medicare beneficiaries are paid based on a prospective payment system, subject to certain limitations. Certain other outpatient services are reimbursed according to fee screens.

**Medicaid** - Inpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost-reimbursement methodology. The Hospital is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

**Other Payers** - The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment under these agreements includes rates per discharge, discounts from established charges, per diem rates, and fee schedule payments.

**Health Care Industry** - The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care 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 is 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 further governmental review and interpretation as well as regulatory actions unknown or unasserted at this time.

**EHR Incentive Payment Revenue** - The American Recovery and Reinvestment Act of 2009 authorized the Centers for Medicare and Medicaid Services (CMS) to award incentive payments to eligible health care providers who demonstrate Meaningful Use of certified electronic health records (EHR). These incentive programs are designed to support providers in this period of health information technology transition and instill the use of EHRs in meaningful ways to help our nation to improve the quality, safety, and efficiency of patient health care. Total received for Medicare amounted to \$1,626,870 and \$0, respectively, and the total received for Medicaid amounted to \$0 and \$618,428, respectively, for the years ended September 30, 2012 and 2011.

**Future Operations** - Current trends in the health care industry include mergers and other forms of affiliations among providers, increasing shifts to managed care, overall reduction in inpatient average length of stay, increasingly restrictive reimbursement policies by governmental and private payers and the prospect of significant changes in legislation at the state and national level. Management cannot assess or project the ultimate effect of these or other items on the future operations of the Hospital.

**Interest in Net Assets of ECHF** - ECHF was formed as a not-for-profit organization to supervise the development activities and engage in investment activities for the benefit of all of the ECHN subsidiaries. ECHN is the sole member of ECHF and ECHF's Board of Directors is appointed by ECHN. The Hospital follows the provisions of FASB ASC 958 (formerly, FASB Statement No. 136, "Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others"). Accordingly, the Hospital has reflected its proportionate interest in the net assets of ECHF in the Hospital's financial statements.

**Income Taxes** - The Hospital is a not-for-profit organization, which is in compliance with the provisions of Internal Revenue Code (IRC) Sec. 501(c)(3) and is exempt from federal tax under IRC Sec. 501(a). At times, the Hospital is involved with activities that subject minor amounts of unrelated business federal income tax, which are paid as they come due in accordance with the Code and the regulations there under. Such amounts are insignificant to the Hospital's financial statements.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

The Hospital accounts for uncertain tax positions in accordance with provisions of FASB ASC 740, “*Income Taxes*” which provides a framework for how companies should recognize, measure, present and disclose uncertain tax positions in their financial statements. The Hospital may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position.

The Hospital does not have any uncertain tax positions as of September 30, 2012 and 2011. As of September 30, 2012 and 2011, the Hospital did not record any penalties or interest associated with uncertain tax positions. The Hospital’s prior three tax years are open and subject to examination by the Internal Revenue Service.

**Asset Retirement Obligations** - The Hospital recognizes a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation is factored into the measurement of the liability when sufficient information exists.

The types of asset retirement obligations that the Hospital recognizes are those for which the Hospital has a legal obligation to perform an asset retirement activity, however, the timing and/or method of settling the obligation are conditional on a future event that may or may not be within its control. The fair value of a liability for the legal obligation associated with an asset retirement is recorded in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement is capitalized.

As of September 30, 2012 and 2011, the Hospital has recognized \$128,578 and \$125,749, respectively, as an obligation to remove asbestos from various buildings upon retirement. This total is included in the balance sheets within other liabilities.

**Accounting for Defined Benefit Pension and Other Postretirement Plans** - The Hospital recognizes the overfunded or underfunded status of their defined-benefit pension and other postretirement benefit plans (collectively, postretirement benefit plans) in the balance sheets as an asset or liability.

The Hospital recognizes changes in the funded status of the plans in the year in which the changes occur as a change in unrestricted net assets presented below the excess of revenues over expenses in its statements of operations and changes in net assets.

**Inventory** - The Hospital records inventory at cost using the first-in, first-out method.

**Impairment of Long-Lived Assets** - Long-lived assets to be held and used are reviewed for impairment whenever circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets to be disposed are reported at the lower of carrying amount or fair value, less cost to sell.

**Estimated Self-Insurance Liabilities** - The liabilities for outstanding losses and loss related expenses and the related provision for losses and loss related expenses include estimates for malpractice losses, general liability, and workers’ compensation incurred but not reported claims as well as losses pending settlement. Such liabilities are necessarily based on estimates and, while management believes the amounts provided are adequate, the ultimate liability may be in excess of or less than the amounts provided. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The methods for making such estimates and the resulting liability are actuarially reviewed on an annual basis, and any adjustments required are reflected in operations in the current period. The current portion of estimated self-insurance liabilities is recorded within other current liabilities in the accompanying balance sheets.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

**Concentration of Credit Risk** - Financial instruments which potentially subject the Hospital to concentration of credit risk consist of accounts receivable, investments, including temporary cash investments, marketable equity and debt securities, mutual funds, government securities and interest rate swap agreements. The Hospital receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payers, including Medicare (a federal program), Medicaid (a State of Connecticut program) and various health insurance companies.

**Interest Rate Swap Agreements** - Interest rate swap agreements are recognized as either assets or liabilities in the balance sheet at fair value regardless of the purpose or intent for holding them. Changes in the fair value of interest rate swap agreements are recognized in other non-operating losses or if designated and effective as hedge transactions, as changes in unrestricted net assets.

**Advertising Costs** - The Hospital expenses advertising costs the first time the advertising takes place. The total amount charged to advertising expense was \$399,319 and \$428,589 for the years ended September 30, 2012 and 2011, respectively, and is recorded in supplies and other expenses in the accompanying statements of operations and changes in net assets.

**Accounting Pronouncements Adopted** - In August 2010, the FASB issued ASU No. 2010-23, "*Health Care Entities (Topic 954): Measuring Charity Care for Disclosure*". ASU No. 2010-23 is intended to reduce the diversity in practice regarding the measurement basis used in the disclosure of charity care. ASU No. 2010-23 requires that cost be used as the measurement basis for charity care disclosure purposes and that cost be identified as the direct or indirect cost of providing the charity care, and requires disclosure of the method used to identify or determine such costs. This ASU is effective for fiscal years beginning after December 15, 2010, with retrospective application required. The Hospital's adoption of ASU 2010-23 did not have a material impact on its overall financial statements.

In August 2010, the FASB issued ASU No. 2010-24, "*Health Care Entities (Topic 954) Presentation of Insurance Claims and Related Insurance Recoveries*". ASU No. 2010-24 clarifies that a health care entity may not net insurance recoveries against related claim liabilities. In addition, the amount of the claim liability must be determined without consideration of insurance recoveries. This ASU is effective for fiscal years beginning after December 15, 2010. The Hospital's adoption of ASU 2010-24 resulted in the recording of additional claim liabilities and insurance recoveries from CHIC in the amounts of \$2,620,000 and \$1,265,000, as of September 30, 2012 and 2011, respectively, which resulted in increasing due from affiliates and the estimated self insurance liabilities.

**Pending Accounting Pronouncements** - In July 2011, the FASB issued ASU No. 2011-07, "*Health Care Entities (Topic 954), Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*", which requires a healthcare entity to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, enhanced disclosures about an entity's policies for recognizing revenue, assessing bad debts, as well as qualitative and quantitative information about changes in the allowance for doubtful accounts are required. The adoption of ASU 2011-07 is effective for the Hospital beginning October 1, 2012.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 2 - Summary of Significant Accounting Policies (continued)**

In May 2011, the FASB issued ASU No. 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS”. ASU No. 2011-04 amends certain guidance in ASC 820, “Fair Value Measurement”. ASU 2011-04 expands ASC 820’s existing disclosure requirements for fair value measurements and makes other amendments. ASU 2011-04 is effective for interim and annual reporting periods beginning after December 15, 2011 and will be applied on a prospective basis.

The Hospital is currently evaluating the effect that the provisions of ASU 2011-04 will have on the Hospital’s financial statements.

**Reclassification** - Certain amounts in the 2011 financial statements have been reclassified to conform to the 2012 presentation. These reclassifications had no material effect on the 2011 financial statements.

**Subsequent Events** - Subsequent events have been evaluated through December 18, 2012, the date through which procedures were performed to prepare the financial statements for issuance. Management believes that there are no subsequent events having a material impact on the financial statements.

**Note 3 - Assets Whose Use is Limited and Investments**

Assets whose use is limited and investments as of September 30, 2012 and 2011, include the following:

	<u>2012</u>		<u>2011</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Board designated and donor-restricted:				
Money market funds	\$ 173,616	\$ 173,616	\$ 72,074	\$ 72,074
Mutual funds:				
Short-term bond fund	4,486,385	4,523,909	4,474,955	4,425,166
Large value fund	5,610,061	6,009,591	5,493,506	4,616,340
Total	<u>\$ 10,270,062</u>	<u>\$ 10,707,116</u>	<u>\$ 10,040,535</u>	<u>\$ 9,113,580</u>
Investments held under bond indenture:				
Money market funds	\$ 958,137	\$ 958,137	\$ 1,971,611	\$ 1,971,611
U.S. government securities	440,896	441,048	420,686	420,196
Total	<u>\$ 1,399,033</u>	<u>\$ 1,399,185</u>	<u>\$ 2,392,297</u>	<u>\$ 2,391,807</u>
Beneficial interest in trust assets	<u>\$ 1,878,052</u>	<u>\$ 2,104,303</u>	<u>\$ 1,741,998</u>	<u>\$ 1,887,242</u>

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 3 - Assets Whose Use is Limited and Investments (continued)**

	<u>2012</u>		<u>2011</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Investments:				
Money market funds	\$ 12,307	\$ 12,307	\$ 7,848	\$ 7,848
Mutual funds:				
Short-term bond fund	22,300	22,633	21,770	21,670
Foreign large growth fund	3,675,987	3,877,646	3,553,132	3,374,470
Large value fund	5,217,633	5,591,406	5,109,189	4,295,105
Moderate allocation funds	41,664	50,319	40,293	41,701
Total	<u>\$ 8,969,891</u>	<u>\$ 9,554,311</u>	<u>\$ 8,732,232</u>	<u>\$ 7,740,794</u>
 Total assets whose use is limited and investments	 <u>\$ 22,517,038</u>	 <u>\$ 23,764,915</u>	 <u>\$ 22,907,062</u>	 <u>\$ 21,133,423</u>

The fair values and gross unrealized losses for all investment categories whose fair value is below its cost and the length of time that the securities have been in an unrealized loss position as of September 30, 2012 and 2011, are as follows:

<u>2012</u>	<u>Less than 12 months</u>		<u>Greater than 12 months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Foreign large growth fund	\$ 400,220	\$ (23,713)	\$ -	\$ -	\$ 400,220	\$ (23,713)
 <u>2011</u>	<u>Less than 12 months</u>		<u>Greater than 12 months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Short-term bond fund	\$ 4,446,836	\$ (49,889)	\$ -	\$ -	\$ 4,446,836	\$ (49,889)
Foreign large growth fund	348,286	(62,965)	3,026,184	(115,697)	3,374,470	(178,662)
Large value fund	-	-	8,911,445	(1,691,250)	8,911,445	(1,691,250)
	<u>\$ 4,795,122</u>	<u>\$ (112,854)</u>	<u>\$ 11,937,629</u>	<u>\$ (1,806,947)</u>	<u>\$ 16,732,751</u>	<u>\$ (1,919,801)</u>

The Hospital's unrealized losses on its investments in mutual funds consist primarily of unrealized losses in the Vanguard Group diversified equity mutual funds as of September 30, 2012 and 2011. The Hospital has evaluated the near-term prospects of the investments in relation to the severity of the impairment (fair value is approximately 1% and 24% less than cost as of September 30, 2012 and 2011, respectively) and recent market trends. Based on that evaluation and the Hospital's ability and intent to hold those investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Hospital does not consider those investments to be other-than-temporarily impaired as of September 30, 2012 and 2011.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 3 - Assets Whose Use is Limited and Investments (continued)**

Interest and dividend income on the assets whose use is limited and investments included within other revenues on the statements of operations and changes in net assets totaled \$449,329 and \$376,415 for the years ended September 30, 2012 and 2011, respectively. There were no realized gains or losses for the years ended September 30, 2012 and 2011.

**Note 4 - Fair Value Measurements**

FASB ASC 820 provides a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. 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 FASB ASC 820 are described as follows:

*Level 1* - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access.

*Level 2* - Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- 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 specified (contractual) terms, 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 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.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 4 - Fair Value Measurements (continued)**

The following table presents the financial instruments carried at fair value as of September 30, 2012 and 2011, by the valuation hierarchy:

<u>2012</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Money market funds	\$ 1,144,060	\$ -	\$ -	\$ 1,144,060
U.S. Government securities	441,048	-	-	441,048
Short-term bond fund	4,546,542	-	-	4,546,542
Foreign large growth fund	3,877,646	-	-	3,877,646
Large value fund	11,600,997	-	-	11,600,997
Moderate allocation funds	50,319	-	-	50,319
Beneficial interest in trusts	-	-	2,104,303	2,104,303
Total assets at fair value	<u>\$ 21,660,612</u>	<u>\$ -</u>	<u>\$ 2,104,303</u>	<u>\$23,764,915</u>
<u>2011</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Money market funds	\$ 2,051,533	\$ -	\$ -	\$ 2,051,533
Fixed income mutual funds	420,196	-	-	420,196
Short-term bond fund	4,446,836	-	-	4,446,836
Foreign large growth fund	3,374,470	-	-	3,374,470
Large value fund	8,911,445	-	-	8,911,445
Moderate allocation funds	41,701	-	-	41,701
Beneficial interest in trusts	-	-	1,887,242	1,887,242
Total assets at fair value	<u>\$ 19,246,181</u>	<u>\$ -</u>	<u>\$ 1,887,242</u>	<u>\$21,133,423</u>

During the years ended September 30, 2012 and 2011, the value of the beneficial interest in trusts increased for a change in market value of \$310,887 and \$1,454, respectively. In addition, the Hospital received \$93,826 and \$72,563 in distributions from these trusts in 2012 and 2011, respectively.

The Hospital's valuation methodologies used to measure financial assets and liabilities at fair value are outlined below. Where applicable, the Hospital uses quoted prices in active markets for identical assets and liabilities to determine fair value (Level 1 inputs). This pricing methodology applies to money market funds, short-term bonds, foreign large growth funds, value index funds, moderate allocation funds and U.S. government securities.

If quoted prices in active markets for identical assets and liabilities are not available, then quoted prices for similar assets and liabilities, quoted prices for identical assets or liabilities in inactive markets or inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly, will be used to determine fair value (Level 2 inputs). As of September 30, 2012 and 2011, the Hospital has no Level 2 inputs.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 4 - Fair Value Measurements (continued)**

Assets and liabilities that are valued using significant unobservable inputs, such as extrapolated data, proprietary models, or indicative quotes that cannot be corroborated with market data are classified in Level 3 within the fair value hierarchy. The Level 3 classification includes the Hospital's beneficial interest in trusts. The value of the Hospital's assets is based on total fund values and the Hospital's corresponding beneficiary percentage.

Fair values of the Hospital's Series C Bonds are based on current traded value. The fair value of the Series C Bonds as of September 30, 2012 and 2011, is approximately \$7,995,981 and \$7,588,066, respectively. The fair value of the Hospital's remaining long-term debt approximates its carrying value.

As of September 30, 2012 and 2011, the Hospital's other financial instruments included accounts receivable, accounts payable and accrued expenses and estimated settlements due from (to) third-party payers. The carrying amounts reported in the balance sheets for these financial instruments approximate their fair value.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Hospital believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

**Note 5 - Property, Plant and Equipment**

Property, plant and equipment as of September 30, 2012 and 2011, consists of the following:

	<u>2012</u>	<u>2011</u>
Land and land improvements	\$ 1,152,087	\$ 1,149,997
Building and building improvements	48,381,424	47,137,460
Fixed equipment	8,686,362	8,579,755
Moveable equipment	<u>35,311,149</u>	<u>33,354,035</u>
	93,531,022	90,221,247
Less: accumulated depreciation and amortization	<u>(63,146,530)</u>	<u>(59,437,084)</u>
	30,384,492	30,784,163
Construction in progress	<u>88,282</u>	<u>367,691</u>
	<u>\$ 30,472,774</u>	<u>\$ 31,151,854</u>

For the years ended September 30, 2012 and 2011, the Hospital capitalized interest related to construction financed with tax-exempt debt of \$15,110 and \$8,873, respectively. The cost to complete the construction in progress is approximately \$90,000 and \$650,000 as of September 30, 2012 and 2011, respectively.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 6 - Unamortized Bond Issue Costs**

Unamortized bond issue costs that are recorded within other - net in the accompanying balance sheets as of September 30, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
Deferred financing costs	\$ 1,346,197	\$ 1,336,197
Less: accumulated amortization	<u>(514,578)</u>	<u>(469,271)</u>
	<u>\$ 831,619</u>	<u>\$ 866,926</u>

**Note 7 - Intangible Assets**

The gross carrying amount and accumulated amortization related to license enhancements as of September 30, 2012 and 2011 consisted of the following:

	<u>2012</u>	<u>2011</u>
Gross carrying amount	\$ 540,000	\$ 540,000
Accumulated amortization	<u>(540,000)</u>	<u>(468,000)</u>
	<u>\$ -</u>	<u>\$ 72,000</u>

Amortization expense related to intangible assets was \$72,000 and \$108,000 for the years ended September 30, 2012 and 2011, respectively.

**Note 8 - Related Party Transactions**

The Network provides certain administrative and operating services to the Hospital and allocates these expenses along with revenues back to the Hospital. The allocation percentage is as follows: MMH 69.8%, RGH 28.9%, and EES 1.3%. The net expenses allocated to the Hospital were \$6,390,430 and \$7,594,237 for the years ended September 30, 2012 and 2011, respectively.

Amounts due from related entities as of September 30, 2012 and 2011, consist of the following:

	<u>2012</u>	<u>2011</u>
EES	\$ 3,947	\$ 180,545
MMH	774,082	1,986,032
Foundation	3,870	-
CHIC	2,620,000	1,265,000
Enterprises	-	30,194
ECHN	-	2,793,961
	<u>\$ 3,401,899</u>	<u>\$ 6,255,732</u>

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 8 - Related Party Transactions (continued)**

Amounts due to related entities as of September 30, 2012 and 2011, consist of the following:

	<b>2012</b>	<b>2011</b>
ECHF	\$ -	\$ 5,986
ECHN	<b>3,297,172</b>	-
ECMPF	-	2,711,364
	<b>\$ 3,297,172</b>	<b>\$ 2,717,350</b>

Amounts due from affiliates consist of operational, working capital, amounts due from CHIC for insurance recoveries and other advances made to ECHN and its affiliates. Management believes the amounts due from ECHN and affiliates can be repaid through ECHN's individual and overall consolidated net asset value. Amounts due to affiliates relate to general operational cash flows.

The Hospital made an equity transfer to ECHN during 2012 and 2011 of \$8,205,356 and \$8,575,553, respectively, to help support the ECHN Network activities.

**Note 9 - Medical Malpractice Insurance**

In fiscal year 2007, ECHN established a single-parent captive, CHIC, which covers all of its subsidiaries, including the Hospital. CHIC provides malpractice and general insurance coverage for ECHN and its subsidiaries at \$3,000,000 per occurrence and \$9,000,000 in the aggregate for the years ended September 30, 2012 and 2011.

Effective October 1, 2009, CHIC also provided an excess healthcare professional liability and umbrella liability insurance policy on a claims made basis covering healthcare professional liability, general care liability, automobile liability, employers liability, helipad liability and non-owned aircraft liability. The limit provided is \$30,000,000 for each loss event and in the annual aggregate excess of the primary coverage layers described above. This coverage is fully reinsured.

Claims that fall within CHIC's policies for medical malpractice and general liability insurance have been asserted against the Hospital by various claimants. The claims are in various stages and some may ultimately be brought to trial. CHIC has employed independent actuaries to estimate the ultimate costs, if any, of the resolution of such claims. As of September 30, 2012 and 2011, no discount was applied to the accrued medical malpractice and general liability reserves.

The Hospital does not self-insure any malpractice risks other than exposures greater than its excess coverage's, however, as of September 30, 2012 and 2011, the Hospital has recorded a liability for estimated incurred but not reported claims, as it currently has a claims-made policy with CHIC. In addition, as mentioned in Note 2, the adoption of ASU 2011-24 resulted in the recording of additional claim liabilities and insurance recoveries from CHIC in the amounts of \$2,620,000 and \$1,265,000, as of September 30, 2012 and 2011, respectively.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 10 - Estimated Self-Insurance Liabilities**

The Hospital is self-insured for workers' compensation insurance coverage. The Hospital participates in Workers' Compensation Trust, a revocable trust, for the purpose of setting aside assets based on actuarial funding recommendations. The Hospital has a \$350,000 limit per occurrence for workers' compensation claims. The Hospital has employed independent actuaries to estimate the ultimate costs, if any, of workers' compensation claims. Accrued workers' compensation reserves have been discounted at 5% as of September 30, 2012 and 2011 and in management's opinion provide an adequate reserve for loss contingencies.

**Note 11 - Pension and Other Postretirement Benefits**

ECHN has a defined benefit pension plan covering substantially all of the employees of the Hospital and MMH. The benefits are based upon years of service and compensation for the five highest years during the employee's last 10 years of service. The Hospital and MMH contribute amounts sufficient to meet the minimum funding requirements of the Employment Retirement Income Security Act of 1974, as well as such additional amounts as deemed appropriate.

Effective December 31, 2008, ECHN implemented a soft freeze on the defined-benefit pension plan. All employees with age and service credits greater than 65 were given the option to stay in the defined-benefit pension plan or freeze their defined benefits and enter into a defined contribution plan. All other employees were required to enter into the defined contribution plan. Under the defined contribution plan, ECHN contributes 3% of eligible employee's salaries. This match is non-guaranteed for all employees except certain union workers. During fiscal years 2012 and 2011, the Hospital incurred expenses of \$757,156 and \$670,836, respectively, related to this plan.

RGH and MMH also sponsor a postretirement benefit plan that provides health care benefits to those employees who retire. The criterion to receive this benefit is to be vested in the pension plan, attain age 55 or older and start collecting under the defined benefit plan described above once retired. The retiree must be enrolled into the medical plan on the date of retirement to be eligible for the continuation. The postretirement health care plan is contributory and the retiree pays 100% of the premium.

Unrestricted net assets of the Hospital and MMH as of September 30, 2012 include unrecognized actuarial losses of \$71,226,109 related to the defined-benefit pension plan and unrecognized actuarial gains of \$877,039 related to the postretirement plan. Of this amount, \$5,481,445 is expected to be recognized in net periodic pension costs in 2013.

The effects of Medicare Prescription Drug, Improvement and Modernization Act of 2003 were reflected as of September 30, 2012 and 2011, assuming that ECHN will continue to provide a prescription drug benefit to retirees that is at least actuarially equivalent to Medicare Part D and that ECHN will receive the federal subsidy. The subsidy reduced plan liabilities by approximately \$1,100,000 for each of the years ended September 30, 2012 and 2011, respectively. Subsidies of \$95,241 and \$95,233 were received in the years ended September 30, 2012 and 2011, respectively. Future benefits of \$397,164 are expected to be paid and future subsidies of \$69,237 are expected to be received related to the year ended September 30, 2012.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 11 - Pension and Other Postretirement Benefits (continued)**

The pension and postretirement plans change in benefit obligation and change in plan assets for the years ended September 30, 2012 and 2011, are as follows (information presented is for the Network (MMH and RGH combined), based on September 30 measurement date):

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
<b>Change in benefit obligation:</b>				
Benefit obligation, beginning of year	\$ 188,714,944	\$ 173,024,122	\$ 4,680,687	\$ 4,502,342
Service cost	2,233,145	1,694,601	63,127	62,573
Interest cost	10,105,635	9,607,108	226,498	211,052
Plan participants' contributions	-	-	507,918	676,830
Receipt of Medicare Part D reimbursement	-	-	95,241	95,233
Actuarial loss (gain)	30,013,892	11,875,070	(140,180)	105,204
Benefits paid	(7,966,121)	(7,485,957)	(800,286)	(972,547)
	<u>\$ 223,101,495</u>	<u>\$ 188,714,944</u>	<u>\$ 4,633,005</u>	<u>\$ 4,680,687</u>
	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
<b>Change in plan assets:</b>				
Fair value of plan assets, beginning of year	\$ 125,293,980	\$ 118,535,420	\$ -	\$ -
Actual return on plan assets	20,980,869	7,674,517	-	-
Employer contributions	10,910,000	6,570,000	197,127	200,484
Plan participants' contributions	-	-	507,918	676,830
Receipt of Medicare Part D reimbursement	-	-	95,241	95,233
Benefits paid	(7,966,121)	(7,485,957)	(800,286)	(972,547)
	<u>\$ 149,218,728</u>	<u>\$ 125,293,980</u>	<u>\$ -</u>	<u>\$ -</u>
	<u>\$ (73,882,767)</u>	<u>\$ (63,420,964)</u>	<u>\$ (4,633,005)</u>	<u>\$ (4,680,687)</u>
Accrued pension and other postretirement benefits				
	<u>\$ 213,696,232</u>	<u>\$ 183,312,903</u>	<u>\$ -</u>	<u>\$ -</u>
Accumulated benefit obligation				

The amounts recognized in the Network's consolidated balance sheets as of September 30, 2012 and 2011 are as follows:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Current liabilities	\$ 3,500,000	\$ 10,910,000	\$ 397,164	\$ 420,446
Non-current liabilities	<u>70,382,767</u>	<u>52,510,964</u>	<u>4,235,841</u>	<u>4,260,241</u>
Net amount recognized	<u>\$ 73,882,767</u>	<u>\$ 63,420,964</u>	<u>\$ 4,633,005</u>	<u>\$ 4,680,687</u>

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 11 - Pension and Other Postretirement Benefits (continued)**

The allocation of the accrued pension and postretirement benefits for the years ended September 30, 2012 and 2011 is as follows:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
MMH	\$ 56,594,968	\$ 48,712,087	\$ 3,608,963	\$ 3,336,703
RGH	<u>17,287,799</u>	<u>14,708,877</u>	<u>1,024,042</u>	<u>1,343,984</u>
Total	<u>\$ 73,882,767</u>	<u>\$ 63,420,964</u>	<u>\$ 4,633,005</u>	<u>\$ 4,680,687</u>

The plan's components of net periodic benefit cost for the years ended September 30, 2012 and 2011, are as follows (pension benefits information presented is for MMH and RGH combined):

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Service cost	\$ 2,233,145	\$ 1,694,601	\$ 63,127	\$ 62,573
Interest cost	10,105,635	9,607,108	226,498	211,052
Expected return on plan assets	(10,959,005)	(10,398,180)	-	-
Amortization of prior service (credits) costs	(234,992)	(234,992)	77,724	77,724
Amortization of net loss (gain)	<u>2,871,791</u>	<u>1,304,258</u>	<u>(43,699)</u>	<u>(57,507)</u>
Net periodic benefit cost	<u>\$ 4,016,574</u>	<u>\$ 1,972,795</u>	<u>\$ 323,650</u>	<u>\$ 293,842</u>

The allocation of the net periodic benefit cost for the years ended September 30, 2012 and 2011, is as follows:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
MMH	\$ 3,060,240	\$ 1,340,948	\$ 252,113	\$ 209,470
RGH	<u>956,334</u>	<u>631,847</u>	<u>71,537</u>	<u>84,372</u>
	<u>\$ 4,016,574</u>	<u>\$ 1,972,795</u>	<u>\$ 323,650</u>	<u>\$ 293,842</u>

The assumptions used to determine the pension and postretirement benefit obligations as of September 30, 2012 and 2011, are as follows:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Discount rate	4.32%	5.47%	3.64%	5.03%
Expected long-term rate of return	8.00%	8.00%	N/A	N/A
Rate of compensation increase	2.75%	2.75%	N/A	N/A
Initial medical trend rate	N/A	N/A	7.91%	8.91%
Ultimate medical trend rate	N/A	N/A	4.50%	4.50%
Number of years to ultimate medical trend rate	N/A	N/A	15 years	17 years

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 11 - Pension and Other Postretirement Benefits (continued)**

The assumptions used to determine net periodic benefits cost of the pension and postretirement benefit obligations for the years ended September 30, 2012 and 2011, are as follows:

	<b>Pension Benefits</b>		<b>Other Postretirement Benefits</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Discount rate	<b>5.47%</b>	5.67%	<b>5.03%</b>	4.88%
Expected long-term rate of return	<b>8.00%</b>	8.00%	<b>N/A</b>	N/A
Rate of compensation increase	<b>2.75%</b>	2.75%	<b>N/A</b>	N/A
Initial medical trend rate	<b>N/A</b>	N/A	<b>7.91%</b>	8.91%
Ultimate medical trend rate	<b>N/A</b>	N/A	<b>4.50%</b>	4.50%
Number of years to ultimate medical trend rate	<b>N/A</b>	N/A	<b>15 years</b>	17 years

The medical trend rate assumption has a significant effect on the amounts reported. A one-percentage-point change in assumed medical trend rates would have the following effects:

	<b>One- Percentage Point Increase</b>	<b>One- Percentage Point Decrease</b>
Effect on year-end postretirement benefit obligation	\$ 382,130	\$ (338,354)
Effect on total of service and interest cost components	\$ 25,275	\$ (22,288)

The pension plan's weighted-average asset allocations as of September 30, 2012 and 2011, by asset category, are as follows:

	<b>Pension Benefits</b>	
	<b>2012</b>	<b>2011</b>
Asset category:		
Equity securities	<b>51%</b>	42%
Debt securities	<b>48%</b>	57%
Cash and cash equivalents	<b>1%</b>	1%
Total	<b>100%</b>	100%

The pension plan's investment policy includes the following asset allocation guidelines:

	<b>2012</b>		<b>2011</b>	
	<b>Policy Target</b>	<b>Range</b>	<b>Policy Target</b>	<b>Range</b>
Asset category:				
Equity securities	<b>53%</b>	<b>40-60%</b>	44%	34-54%
Debt securities	<b>46%</b>	<b>45-50%</b>	56%	51-61%
Cash and cash equivalents	<b>1%</b>	<b>0-4%</b>	0%	0-4%

**The Rockville General Hospital, Inc.**  
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**As of and for the Years Ended September 30, 2012 and 2011**

**Note 11 - Pension and Other Postretirement Benefits (continued)**

The asset allocation policy was developed in consideration of the following long-term investment objectives: maximizing portfolio returns with at least a return of 4%, net of all trading expenses and fees, above inflation, as measured by the Consumer Price Index and achieving portfolio returns, which exceed a composite index consisting of the S&P 500, the Russell 2000 Index, Ryan Labs GIC Index, and the Barclays Capital Aggregate Bond Index in the same proportion as the fund's average commitment to equity and fixed income, respectively, and to rank in the top quartile of a broad universe of corporate pension plans of similar size.

The expected long-term rate-of-return-on-assets assumption was determined by evaluating portfolio returns based on capital market assumptions over a 20-year time horizon which are reduced by expected transaction costs and expected investment management fees for passively invested assets (to the extent that such fees are expected to be paid out of plan assets rather than directly by the Network).

Fair value methodologies used to assign plan assets to levels in accordance with ASC 820 are consistent with the inputs described in Note 4.

The following table presents the investments of the defined benefit plan carried at fair value as of September 30, 2012 and 2011, by the valuation hierarchy.

<u>2012</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 944,555	\$ -	\$ -	\$ 944,555
Fixed income mutual funds:				
Long duration	53,025,749	-	-	53,025,749
US Core Opportunistic	12,088,551	-	-	12,088,551
US Passive	2,983,658	-	-	2,983,658
Guaranteed investment contract	183,256	-	3,195,313	3,378,569
Equities:				
Small/mid cap	8,232,969	-	-	8,232,969
Active long cap	11,917,531	-	-	11,917,531
Large cap	30,277,740	-	-	30,277,740
International	26,369,406	-	-	26,369,406
 Total	 <u>\$ 146,023,415</u>	 <u>\$ -</u>	 <u>\$ 3,195,313</u>	 <u>\$ 149,218,728</u>

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 11 - Pension and Other Postretirement Benefits (continued)**

<u>2011</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 588,004	\$ -	\$ -	\$ 588,004
Fixed income mutual funds:				
Long duration	56,839,238	-	-	56,839,238
US Core Opportunistic	9,716,075	-	-	9,716,075
US Passive	1,738,106	-	-	1,738,106
Guaranteed investment contract	170,915	-	3,374,535	3,545,450
Equities:				
Small/mid cap	5,699,196	-	-	5,699,196
Large cap	26,548,136	-	-	26,548,136
International	20,619,775	-	-	20,619,775
 Total	 <u>\$ 121,919,445</u>	 <u>\$ -</u>	 <u>\$ 3,374,535</u>	 <u>\$ 125,293,980</u>

The changes within the level 3 investments as of September 30, 2012 and 2011 is as follows:

<u>2012</u>	<u>Guaranteed Investment Contract</u>		
Balance as of October 1, 2011	\$ 3,374,535		
Investment income	194,239		
Expenditures	<u>(373,461)</u>		
 Balance as of September 30, 2012	 <u>\$ 3,195,313</u>		

  

<u>2011</u>	<u>Real Estate Securities</u>	<u>Guaranteed Investment Contract</u>	<u>Total</u>
Balance as of October 1, 2010	\$ 2,333,339	\$ 3,571,198	\$ 5,904,537
Investment return:			
Investment income	-	237,985	237,985
Net change in market value	498,504	-	498,504
Proceeds from sale of investment	(2,831,843)	-	(2,831,843)
Expenditures	<u>-</u>	<u>(434,648)</u>	<u>(434,648)</u>
 Balance as of September 30, 2011	 <u>\$ -</u>	 <u>\$ 3,374,535</u>	 <u>\$ 3,374,535</u>

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 11 - Pension and Other Postretirement Benefits (continued)**

During fiscal year 2013, ECHN anticipates contributing \$3,500,000 to the defined benefit plan.

The future benefit payments, which reflect estimated future service and expected to be paid from the plans for the year ended September 30, 2012, are as follows:

	<b>Pension Benefits</b>	<b>Other Postretirement Benefits</b>
2013	\$ 7,839,728	\$ 397,164
2014	\$ 8,177,609	\$ 409,051
2015	\$ 8,613,029	\$ 104,768
2016	\$ 9,079,307	\$ 405,187
2017	\$ 9,773,496	\$ 418,484
2018-2022	\$ 58,816,410	\$ 2,087,013

The Hospital also has a defined contribution employee savings plan covering substantially all employees. Eligible employees who contribute to the plan will have 20% - 50%, depending upon years of service, of contributions matched by the Hospital, up to a maximum of 6% of annual compensation. Contributions to the plan were suspended for non-union employees from April 2009 to April 2010. The Hospital incurred expenses related to the employee savings plan amounting to \$12,629 and \$258,650 for the years ended September 30, 2012 and 2011, respectively.

**Note 12 - Long-Term Debt**

Long-term debt, as of September 30, 2012 and 2011, consists of the following:

	<b>2012</b>	<b>2011</b>
The Hospital's portion of CHEFA Hospital Revenue Bonds, ECHN Issue, Series C, bearing interest at rates ranging from 4.00% to 5.125% - net of amortized original issue premium of \$85,468 and \$90,216 in 2012 and 2011, respectively.	<b>\$ 7,936,518</b>	\$ 8,112,616
The Hospital's portion of the CHEFA Hospital Demand Revenue Bonds, ECHN Issue Series E bearing interest at a variable rate, adjusted weekly.	<b>16,263,000</b>	17,662,500
The Hospital's portion of the loan due to Chase Equipment Leasing Inc., face amount allocated to RGH of \$1,680,000, due and payable in monthly principal and interest installments maturing on March 20, 2013 and bearing interest at 3.24%.	<b>249,251</b>	735,817
Capital lease obligations (see Note 13)	<b>1,216,986</b>	596,693
Total long-term debt	<b>25,665,755</b>	27,107,626
Less: current maturities	<b>(1,271,671)</b>	(1,247,313)
Long-term debt - net	<b>\$ 24,394,084</b>	\$ 25,860,313

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 12 - Long-Term Debt (continued)**

In February 2000, the Hospital, MMH and EES (collectively, the Series A Obligated Group) entered into an agreement and open-ended mortgage with Connecticut Health and Educational Facilities Authority (CHEFA) in connection with the issuance of CHEFA Hospital Revenue Bonds, Eastern Connecticut Health Network, Issue Series 2000A (the Series A Bonds). A portion of the proceeds from the Series 2000A bonds, net of the original issue discount and amounts used to establish required reserve accounts, was placed in an irrevocable trust from which the remaining debt service payments for defeased CHEFA bonds will be paid. The remainder was used to finance additions and renovations for various facilities. The Series A Obligated Group has been legally released from any future debt service on the defeased bonds. The Series A Bonds are due on various dates through July 1, 2030.

In July 2004, the Hospital, MMH, EES and ECHF (collectively, the Series B Obligated Group) entered into an agreement and open-ended mortgage with CHEFA in connection with the issuance of CHEFA Hospital Revenue Bonds, Eastern Connecticut Health Network Issue, Series B (the Series B Bonds). A portion of the proceeds from the Series B Bonds, net of the original issue discount and amounts used to establish required reserve accounts, was used to finance additions, renovations and purchases of equipment for RGH and MMH.

The Series B bonds were refinanced as part of the issuance of Series E bonds as described below.

On October 1, 2005, the Hospital, MMH, EES and ECHF (collectively, the Series C Obligated Group) entered into an agreement and open-ended mortgage with the CHEFA to borrow \$37,065,000 in connection with the issuance of CHEFA Hospital Revenue Bonds, Eastern Connecticut Health Network Issue, Series C (the Series C Bonds). The proceeds from the Series C Bonds, net of the original issue premium and amounts used to establish required reserve accounts, were placed in an irrevocable trust to advance refund and defease a portion of the Series 2000A Bonds. MMH, RGH and EES (collectively, the Series A Obligated Group) have been legally released from any future debt service on the portion of defeased Series 2000A Bonds. The Series C Bonds are due on various dates through July 1, 2030.

In May 2009, the Hospital, MMH, EES and ECHF (collectively, the Series D Obligated Group) entered into an agreement and open-ended mortgage with CHEFA in connection with the issuance of CHEFA Hospital Revenue Bonds, Eastern Connecticut Health Network, Issue Series D (the Series D Bonds). The proceeds from the Series D Bonds, net of amounts used to establish required reserve accounts, were used to finance renovations at MMH, an expansion at EES and other campus improvements. The Series D Bonds are due on various dates through May 14, 2039.

In December 2010, the Hospital, MMH, EES and ECHF (collectively, the Series E Obligated Group) entered into an agreement and open-ended mortgage with CHEFA in connection with the issuance of CHEFA Hospital Revenue Bonds, Eastern Connecticut Health Network, Issue Series E (the Series E Bonds). The proceeds from the Series E Bonds, net of amounts used to establish required reserve accounts, were used to redeem the Series B Bonds and fund interest rate swap agreement termination payments relating to the Series B Bonds. Series E Bonds are due on various dates through July 1, 2034.

Under the terms of the Series A, Series B, Series C, Series D and Series E Bonds, the Series A Obligated Group, Series B Obligated Group, Series C Obligated Group, Series D Obligated Group and Series E Obligated Group (the Obligated Groups) are required to maintain certain deposits with a trustee. Such deposits are included in assets whose use is limited. The indenture also places limits on the incurrence of additional borrowings and dispositions of property and requires that the Obligated Groups satisfy certain measures of financial performance as long as the notes are outstanding.

**The Rockville General Hospital, Inc.**  
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**Note 12 - Long-Term Debt (continued)**

The Obligated Groups are required to comply with certain financial covenants (as defined in the trust agreements) including a debt service coverage ratio, days cash on hand requirement and minimum cash to debt ratio. As of September 30, 2012 and 2011, the Obligated Groups were in compliance with the financial covenants of the debt agreements; however, ECHN had to receive a waiver from TD Bank, N.A. (under a letter of credit agreement for Series D and E bonds) for transfers to affiliated organizations outside the Obligated Group in excess of \$4.0 million for the year ended September 30, 2011. The letter of credit agreement was amended in fiscal year 2012 to eliminate this requirement.

Under the terms of the CHEFA agreements, each member of the Obligated Groups is jointly and severally liable for the full and prompt payment of the amounts owed by the Obligated Groups. Total debt of the Obligated Groups was \$81,999,098 and \$80,156,296 as of September 30, 2012 and 2011, respectively. The debt is also secured by the gross receipts of the Obligated Groups.

The loans due to Chase Equipment Leasing Inc. are collateralized by the related equipment, accessories, attachments, software and other property relating thereto.

The Hospital is party to various capital leases, which are described in Note 13.

The annual maturities of the Hospital's portion of the long-term debt in each of the succeeding five years and thereafter as of September 30, 2012 are as follows:

2013	\$	1,271,671
2014		870,081
2015		886,580
2016		873,156
2017		789,500
Thereafter		<u>20,889,299</u>
		25,580,287
Plus premium - net		<u>85,468</u>
Total	\$	<u><u>25,665,755</u></u>

**Note 13 - Lease Commitments**

The Hospital leases equipment under capital lease agreements entered into on May 19, 2011, which expire in 2016. The interest rates range from 3.71% to 4.09%. The net carrying value of the equipment under the capital lease was \$1,281,139 and \$600,072 as of September 30, 2012 and 2011, respectively and is included in property, plant and equipment.

The Hospital leases various office spaces and certain equipment under operating leases that expire in various years through fiscal year 2013. Certain leases may be renewed at the end of their term.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 13 - Lease Commitments (continued)**

Future minimum payments under capital and non-cancelable operating leases as of September 30, 2012 are as follows:

	<u>Capital Leases</u>	<u>Operating Leases</u>
2013	\$ 449,339	\$ 752,729
2014	278,135	629,180
2015	278,135	629,180
2016	218,973	629,180
2017	67,118	629,180
Thereafter	-	4,384,017
	<u>1,291,700</u>	<u>\$ 7,653,466</u>
Less: interest on capital lease	<u>74,714</u>	
Principal amount of capital lease	<u>\$ 1,216,986</u>	

Rent expense under month-to-month leases was \$716,133 and \$425,376 for the years ended September 30, 2012 and 2011, respectively.

**Note 14 - Concentrations of Credit Risk**

The Hospital grants credit without collateral to its patients, most of who are insured under third-party payer agreements. The mix in patient accounts receivable as of September 30, 2012 and 2011, before allowances for doubtful accounts, consists of the following:

	<u>2012</u>	<u>2011</u>
Self-pay	<b>32%</b>	26%
Managed care	<b>20%</b>	20%
Medicare	<b>26%</b>	29%
Commercial insurance	<b>5%</b>	5%
Medicaid	<b>13%</b>	17%
Other	<b>4%</b>	3%
	<u><b>100%</b></u>	<u>100%</u>

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
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**Note 15 - Net Patient Service Revenue**

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

	<u>2012</u>	<u>2011</u>
Patient service revenue:		
Inpatient services	\$ 69,889,867	\$ 54,124,324
Outpatient services	<u>118,179,406</u>	<u>93,948,299</u>
Gross patient service revenue	<b>188,069,273</b>	148,072,623
Deductions - allowances	<u>(120,221,635)</u>	<u>(84,685,507)</u>
Net patient service revenue	<u><b>\$ 67,847,638</b></u>	<u><b>\$ 63,387,116</b></u>

**Note 16 - Community Benefit**

ECHN's mission is to improve the health of the people and communities ECHN serves.

ECHN provides quality health care to all, regardless of their ability to pay. Charity care is provided to those who are eligible based on ECHN's policy. ECHN also incurs unpaid costs for government programs because reimbursement is not sufficient to cover costs associated with Medicare and Medicaid patients. In addition to the charity care responsibilities, ECHN provides numerous other community benefits. These community benefits include medical education and research, community health education, screenings, support groups, counseling services and in-kind support. To address the need for health care providers, a number of programs are offered for young people who may be interested in a career in health care.

ECHN utilizes guidelines developed by various organizations to quantify community benefit activities. ECHN defines community benefit activities as those that improve access to care, as well as the health of the broader community. In addition to charity care and the unpaid costs of government sponsored health care (Medicare and/or Medicaid shortfalls), community benefit activities will normally fall into one of the following categories: nonbilled community health services community health improvement services, health professions education, subsidized health services, research, financial and in-kind contributions, community building activities and community benefit operations.

The Hospital has a policy of providing charity care to patients who are unable to pay. Such patients are identified based on financial information obtained from the patient and subsequent analysis. Since the Hospital does not expect payment, estimated charges for charity care are not included in revenue. The amount of traditional charity care provided, determined on the basis of cost, was estimated at \$742,084 and \$332,078 for the years ended September 30, 2012 and 2011, respectively. Previously, the Hospital reported its estimates of services provided under its charity care programs based on gross charges. In connection with the Hospital's adoption of ASU 2010-23, "Health Care Entities (Topic 954): Measuring Charity Care for Disclosure," amounts previously reported for care provided under its charity care programs have been restated to reflect the Hospital's estimates of its direct and indirect cost of providing these services. This change had no impact on the Hospital's results of operations.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 17 - Functional Expenses**

The Hospital provides general health care services to residents within its geographic location. Expenses relating to providing these services for the years ended September 30, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
Health care services	\$ 62,933,113	\$ 57,814,626
General and administrative	<u>11,105,841</u>	<u>10,202,573</u>
Total	<u>\$ 74,038,954</u>	<u>\$ 68,017,199</u>

**Note 18 - Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets as of September 30, 2012 and 2011, are available for the following purposes:

	<u>2012</u>	<u>2011</u>
Departmental purposes	\$ 606,707	\$ 893,842
Capital campaign and pledges	<u>9,041</u>	<u>18,690</u>
Total	<u>\$ 615,748</u>	<u>\$ 912,532</u>

Permanently restricted net assets as of September 30, 2012 and 2011, consist of the following:

	<u>2012</u>	<u>2011</u>
Endowment restricted for other health care services	\$ 1,309,475	\$ 1,309,475
Endowment restricted for charity care	219,388	219,388
Beneficial interest in trust assets	<u>2,104,303</u>	<u>1,887,242</u>
Total	<u>\$ 3,633,166</u>	<u>\$ 3,416,105</u>

The composition of the Hospital's endowment by net asset class as of September 30, 2012 and 2011 was as follows:

<u>2012</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 449,474	\$ 1,246,575	\$ 1,696,049
Board-designated endowment funds	<u>9,011,067</u>	<u>-</u>	<u>-</u>	<u>9,011,067</u>
Net assets, September 30, 2012	<u>\$ 9,011,067</u>	<u>\$ 449,474</u>	<u>\$ 1,246,575</u>	<u>\$ 10,707,116</u>

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 18 - Temporarily and Permanently Restricted Net Assets (continued)**

<u>2011</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 771,974	\$ 1,246,575	\$ 2,018,549
Board-designated endowment funds	<u>7,095,031</u>	<u>-</u>	<u>-</u>	<u>7,095,031</u>
Net assets, September 30, 2011	<u>\$ 7,095,031</u>	<u>\$ 771,974</u>	<u>\$ 1,246,575</u>	<u>\$ 9,113,580</u>

The Hospital's endowments consist of multiple funds established for a variety of purposes. The endowments include both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. As required by GAAP, endowments, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor restrictions.

The Hospital has interpreted the relevant laws as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. 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 Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the Hospital and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the Hospital; and (7) the investment policies of the Hospital.

The Hospital has adopted investment and spending policies for endowment assets that attempt to provide a reasonably stable and predictable stream of earnings to support the operations of the endowments and to preserve and enhance over time the real value of the endowment assets. Under this policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce a real return, net of inflation and investment and management costs, over the long-term. Actual returns in any given year may vary from this amount.

The Investment Committee of the Board is responsible for defining and reviewing the investment policy to determine an appropriate long-term asset allocation policy. The asset allocation policy reflects the objective with allocations structured for capital growth and inflation protection over the long-term.

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

The Hospital has not appropriated funds for expenditure from its endowment funds for the years ended September 30, 2012 and 2011.

**The Rockville General Hospital, Inc.**  
**Notes to the Financial Statements**  
**As of and for the Years Ended September 30, 2012 and 2011**

**Note 18 - Temporarily and Permanently Restricted Net Assets (continued)**

Changes in Hospital's endowments for the years ended September 30, 2012 and 2011 are as follows:

<u>2012</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Net assets, October 1, 2011	\$ 7,095,031	\$ 771,974	\$ 1,246,575	\$ 9,113,580
Interest income and dividends	215,487	14,039	-	229,526
Unrealized appreciation on investments	1,276,744	87,266	-	1,364,010
Transfers (to)/from endowment	<u>423,805</u>	<u>(423,805)</u>	<u>-</u>	<u>-</u>
Net assets, September 30, 2012	<u>\$ 9,011,067</u>	<u>\$ 449,474</u>	<u>\$ 1,246,575</u>	<u>\$ 10,707,116</u>
<u>2011</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Net assets, October 1, 2010	\$ 6,955,185	\$ 825,128	\$ 1,246,575	\$ 9,026,888
Interest income and dividends	173,699	9,779	-	183,478
Unrealized depreciation on investments	<u>(33,853)</u>	<u>(62,933)</u>	<u>-</u>	<u>(96,786)</u>
Net assets, September 30, 2011	<u>\$ 7,095,031</u>	<u>\$ 771,974</u>	<u>\$ 1,246,575</u>	<u>\$ 9,113,580</u>

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or relevant law requires the Hospital to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets. As of September 30, 2012 and 2011, there were no funds that were below the level required by donor or law.

**Note 19 - Commitments and Contingencies**

The Hospital is involved in various legal actions arising from the normal course of its activities. Although the ultimate outcome is not determinable at this time, management, after taking into consideration the advice of legal counsel, believes that the resolution of these pending matters will not have a material adverse effect, individually or in the aggregate, upon the balance sheets or the related statements of operations and changes in net assets, or cash flows of the Hospital.

The Hospital and the Hospital's defined benefit pension plans invest in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term.