

THE WATERBURY HOSPITAL AND SUBSIDIARIES

**CONSOLIDATED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION**

SEPTEMBER 30, 2012 AND 2011

THE WATERBURY HOSPITAL AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
The Waterbury Hospital

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

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

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

As described in Note 1, the Hospital has restated its 2011 financial statements during the current year to include the inventory of certain departments that previously had been excluded and to correct the overstatement of accounts receivable. Our opinion is not modified with respect to these matters.

Marcum LLP

Hartford, CT
January 28, 2013

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2012 AND 2011

	2012	2011 (Restated)
Assets		
Current Assets		
Cash and cash equivalents	\$ 28,119,173	\$ 15,410,669
Short-term investments	448,318	401,931
Patient accounts receivable, less allowance (\$17,046,000 in 2012 and \$15,096,000 in 2011)	31,771,976	29,030,710
Grants and other receivables	2,977,504	4,228,499
Inventories of supplies	3,305,079	3,258,762
Prepaid insurance and other expenses	1,493,512	1,747,158
Due from third-party reimbursement agencies	--	2,858,086
Due from affiliates	--	3,848,949
Total Current Assets	68,115,562	60,784,764
Other Assets		
Funds held in escrow by agreement with the State of Connecticut Health and Educational Facilities Authority (CHEFA) and trustee: Construction fund	661,338	3,958,301
	661,338	3,958,301
Funds held in trust by others	42,218,163	37,339,264
Long-term investments	10,001,712	8,760,627
Board-designated endowment funds	2,974,503	2,615,009
Other receivables	290,416	3,240
Goodwill	1,813,567	1,813,567
CHEFA obligations issue expense, less amortization	321,666	360,656
	57,620,027	50,892,363
Property, plant and equipment:		
Land	287,549	287,549
Buildings and improvements	92,117,304	88,987,893
Equipment	184,952,035	180,860,538
Construction in progress (estimated additional cost to complete: 2012 - \$970,000)	2,473,015	3,023,126
	279,829,903	273,159,106
Less accumulated depreciation	(230,695,459)	(223,542,449)
	49,134,444	49,616,657
	\$ 175,531,371	\$ 165,252,085

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)

SEPTEMBER 30, 2012 AND 2011

	2012	2011 (Restated)
Liabilities and Net Assets		
Current Liabilities		
Accounts payable and accrued expenses	\$ 28,420,641	\$ 29,080,389
Salaries, wages, payroll taxes and amounts withheld from employees	8,325,174	10,097,040
Due to third-party reimbursement agencies	601,271	--
Current portion of CHEFA obligations	451,444	423,779
Current portion of notes payable	666,376	584,216
Due to affiliates	2,999,940	--
Total Current Liabilities	41,464,846	40,185,424
Other Noncurrent Liabilities	21,853,067	19,806,617
CHEFA Obligations - less current portion and discount	24,755,656	25,207,100
Notes Payable - less current portion	1,426,291	1,499,034
Net Assets		
Unrestricted	30,228,350	28,763,004
Temporarily restricted	7,645,420	6,477,454
Permanently restricted	45,010,199	40,131,275
Total Net Assets Excluding Noncontrolling Interests	82,883,969	75,371,733
Noncontrolling Interests	3,147,542	3,182,177
Total Net Assets	86,031,511	78,553,910
	\$ 175,531,371	\$ 165,252,085

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011 (Restated)
Unrestricted Revenues		
Net revenues from services to patients	\$ 269,112,543	\$ 265,862,860
Other operating revenues	5,784,691	3,690,631
Net assets released from restrictions	5,609,005	5,919,545
	<u>280,506,239</u>	<u>275,473,036</u>
Operating Expenses		
Salaries	124,608,715	134,272,520
Employee benefits	35,479,916	35,381,121
Supplies and other	98,648,364	90,852,318
Bad debts	10,964,528	13,868,167
Depreciation	9,241,684	9,313,313
Operations improvement	--	285,998
Interest and amortization	1,160,533	1,202,403
	<u>280,103,740</u>	<u>285,175,840</u>
Income (Loss) from Operations	402,499	(9,702,804)
Nonoperating Gains (Losses)		
Unreimbursed start-up costs	--	(202,579)
Unrestricted gifts and bequests	83,577	276,737
Investment income	1,607,608	1,682,054
Loss on extinguishment of debt	--	(1,082,212)
	<u>1,691,185</u>	<u>674,000</u>
Excess (Deficiency) of Revenues over Expenses Before Changes in Net Unrealized Gains (Losses) on Investments	2,093,684	(9,028,804)
Changes in Net Unrealized Gains (Losses) on Investments	392,543	(529,738)
Excess (Deficiency) of Revenues over Expenses	2,486,227	(9,558,542)
Less Excess of Revenues over Expenses Attributable to Noncontrolling Interests	(997,139)	(1,111,268)
Excess (Deficiency) of Revenues Over Expenses Attributable to Controlling Interest	<u>1,489,088</u>	<u>(10,669,810)</u>

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS (CONTINUED)

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011 (Restated)
Unrestricted Net Assets, Controlling Interest		
Excess (deficiency) of revenues over expenses	\$ 1,489,088	\$ (10,669,810)
Net assets released from restrictions used for purchase of property and equipment	134,036	1,207,613
Interest rate swap adjustment	(524,547)	(2,414,415)
Pension liability adjustments	366,769	(1,816,446)
Increase (Decrease) in Unrestricted Net Assets, Controlling Interest	1,465,346	(13,693,058)
Unrestricted Net Assets, Noncontrolling Interest		
Excess of revenues over expenses	997,139	1,111,268
Distributions and other	(1,031,774)	(859,144)
(Decrease) Increase in Unrestricted Net Assets, Noncontrolling Interest	(34,635)	252,124
Temporarily Restricted Net Assets		
Gifts and bequests	444,830	446,319
Income from investments	476,299	481,072
Net realized and unrealized gains (losses) on investments	1,255,981	(347,727)
Grants	4,733,897	4,709,075
Net assets released from restrictions	(5,743,041)	(7,127,158)
Increase (Decrease) in Temporarily Restricted Net Assets	1,167,966	(1,838,419)
Permanently Restricted Net Assets		
Increase (decrease) in fair value of funds held in trust by others	4,878,924	(2,221,826)
Increase (Decrease) in Permanently Restricted Net Assets	4,878,924	(2,221,826)
Increase (Decrease) in Net Assets	7,477,601	(17,501,179)
Net Assets - Beginning	78,553,910	96,055,089
Net Assets - End	\$ 86,031,511	\$ 78,553,910

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011
		(Restated)
Operating Activities and Nonoperating Revenues		
Change in net assets	\$ 7,477,601	\$ (17,501,179)
Adjustments to reconcile change in net assets to net cash provided by operating activities and nonoperating revenues:		
Provision for bad debts	10,964,528	13,868,167
Depreciation and amortization	9,349,683	9,437,478
Loss on extinguishment of debt	--	1,082,212
Pension liability adjustments	(366,769)	1,816,446
Distributions to noncontrolling interests	1,031,774	859,144
Net realized and unrealized (gains) and losses and change in fair value of funds held in trust by others	(6,527,448)	3,099,291
Restricted gifts, bequests and income from investments	(921,129)	(927,391)
Change in market value of interest rate swap	524,547	2,414,415
	<u>21,532,787</u>	<u>14,148,583</u>
Changes in operating working capital other than cash and cash equivalents:		
Other assets required for current liabilities	--	582,693
Patient accounts receivable, net	(13,705,794)	(16,213,439)
Grants and other receivables	1,406,813	(738,772)
Inventories of supplies	(46,317)	(46,402)
Prepaid insurance and other expenses	253,646	(370,378)
Accounts payable and accrued expenses	(815,566)	8,354,803
Salaries, wages, payroll taxes and amounts withheld from employees	(1,771,866)	892,098
Due to third-party reimbursement agencies	3,459,357	(3,088,396)
Increase in other noncurrent liabilities	1,819,663	908,338
	<u>(9,400,064)</u>	<u>(9,719,455)</u>
Net Cash Provided by Operating Activities and Nonoperating Revenues	<u>12,132,723</u>	<u>4,429,128</u>

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011
		(Restated)
Cash Flows from Investing Activities		
Purchases of investments	\$ (4,884,095)	\$ (5,672,215)
Sales of investments	4,885,678	6,063,449
Due from affiliates	6,848,889	1,667,541
Other assets	3,009,787	(4,409,404)
Additions to property, plant and equipment	<u>(8,759,471)</u>	<u>(15,639,575)</u>
Net Cash Provided by (Used in) Investing Activities	<u>1,100,788</u>	<u>(17,990,204)</u>
Cash Flows from Financing Activities		
Restricted gifts, bequests and income from investments	921,129	927,391
Distributions to noncontrolling interests	(1,031,774)	(859,144)
Proceeds from issuance of debt	616,571	27,373,773
Principal payments on debt obligations	<u>(1,030,933)</u>	<u>(19,877,123)</u>
Net Cash (Used in) Provided by Financing Activities	<u>(525,007)</u>	<u>7,564,897</u>
Net Increase (Decrease) in Cash and Cash Equivalents	12,708,504	(5,996,179)
Cash and Cash Equivalents - Beginning	<u>15,410,669</u>	<u>21,406,848</u>
Cash and Cash Equivalents - End	<u>\$ 28,119,173</u>	<u>\$ 15,410,669</u>

Supplemental Cash Flow Information

Cash paid during the year for interest on borrowings was \$1,319,213 and \$1,197,462 for the years ended September 30, 2012 and 2011, respectively.

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION

ORGANIZATION

The Waterbury Hospital (the Hospital), a voluntary association incorporated under the General Statutes of the State of Connecticut, is a wholly-owned subsidiary of Greater Waterbury Health Network, Inc. (sole member) (the Network). The Board of the Hospital, which is appointed by the Network, controls the operations of the Hospital. In addition to the Hospital, the accompanying financial statements include Access Rehab Centers LLC (Access), Greater Waterbury Imaging Center Limited Partnership (GWIC), Imaging Partners, LLC, Alliance Medical Group, Inc. (AMG) and Cardiology Associates of Greater Waterbury, LLC (CAGW) to the extent of the Hospital's ownership interest in these affiliated entities.

On August 17, 2011, the Network executed a nonbinding letter of intent to enter into a joint venture known as Southwest Connecticut Health System, LLC, being formed by a subsidiary of LHP Hospital Group, Inc. and Saint Mary's Health System, Inc. which anticipated combining the two health systems in Waterbury, Connecticut and constructing a replacement hospital. This agreement was terminated on August 31, 2012.

During November 2010, the Hospital established a limited liability company by the name of Cardiology Associates of Greater Waterbury, LLC to operate a cardiology practice. CAGW acquired the assets of Cardiology Associates of Waterbury (CAW) that were used by CAW physicians in the performance of their professional services.

Waterbury Hospital also acquired the assets of CAW that were used by CAW to perform diagnostic ancillary services. The Hospital converted these ancillary services to provider-based services, which are provided at a diagnostic center located near the Hospital. The goodwill recorded on the consolidated balance sheets relates to the purchase of CAW.

During June 2010, the Hospital entered into an arrangement with certain gastroenterology physician-members of the Hospital's medical staff to form Waterbury Gastroenterology Co-Management Company, LLC (GI Co-Management Company), a Connecticut limited liability company. This company was formed as a collaborative effort between the Hospital and the physicians for the purpose of improving the quality and efficiency of the gastroenterology service line at the Hospital. The Hospital's investment of \$50,000 in the GI Co-Management Company is included in the Hospital's consolidated financial statements in long-term investments.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION

The Hospital entered into a members' agreement, making it an equal member with St. Mary's Hospital, located in Waterbury, Connecticut, in a joint venture to form The Harold LEEVER Regional Cancer Center, Inc. (the Cancer Center). The Cancer Center is a Connecticut non-stock corporation exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The purpose of the joint venture is to develop, construct, own and operate the Cancer Center. Both member hospitals transferred the revenue and related expenses of their respective radiation oncology services to the Cancer Center in October 2002. Both member hospitals made working capital advances to the Cancer Center. The Cancer Center is not included in the Hospital's consolidated financial statements.

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

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Hospital and the affiliated entities. Recognition has been given to noncontrolling interests in the affiliates which is reflected as a component of unrestricted net assets. All significant intercompany accounts and transactions are eliminated in consolidation.

USE OF ESTIMATES

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

REGULATORY MATTERS

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are available to provide grant related services, free care, and educational seminars. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity or in funds held in trust by others.

DONOR RESTRICTED GIFTS

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets.

PROMISES TO GIVE

Unconditional promises to give are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises to give are received. Amortization of the discounts is included in gifts and bequests on the statements of operations and changes in net assets.

CASH AND CASH EQUIVALENTS

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

ACCOUNTS RECEIVABLE

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

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

INVENTORIES

Inventories are stated at the lower of cost or market. The Hospital values its inventories using the first in first out method.

INVESTMENTS

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

Unrealized gains and losses on investments related to permanently restricted net assets and certain temporarily restricted net assets are included in temporarily restricted net assets under State law which allows the Board of Trustees to appropriate as much of the net appreciation of investments as is prudent considering the Hospital's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions. Reference is made to Note 5.

OTHER ASSETS

Other assets include assets held by trustees under indenture agreements relating to financing activities with the State of Connecticut Health and Education Facilities Authority. The portion of these amounts required for funding current liabilities is included in current assets.

PROPERTY, PLANT AND EQUIPMENT

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Financial Accounting Standards Board (FASB) ASC 410-20, *Accounting for Asset Retirement Obligations* (ASC 410-20), provides guidance on accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Asset retirement obligations include, but are not limited to, certain types of environmental issues which are legally required to be remediated upon an asset's retirement as well as contractually required asset retirement obligations. ASC 410-20 provides clarifying guidance on conditional asset retirement obligations. Conditional asset retirement obligations are obligations whose settlement may be uncertain.

ASC 410-20's guidance requires such conditional asset retirement obligations to be estimated and recognized. Application of these pronouncements affects the Hospital with respect to required future asbestos remediation.

Conditional asset retirement obligations of \$2,785,468 and \$2,716,459 as of September 30, 2012 and 2011, respectively, are recorded in other noncurrent liabilities. During 2012 and 2011, there were no retirement obligations incurred or settled.

GOODWILL

Goodwill, which has an indefinite life, is not amortized and is evaluated for impairment whenever events or business conditions indicate that the carrying values of such assets may not be fully recoverable.

IMPAIRMENT OF LONG-LIVED ASSETS

The Hospital records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. There were no impairment losses recorded in 2012 and 2011.

NONOPERATING GAINS (LOSSES)

Activities, other than in connection with providing health care services, are considered to be nonoperating. Nonoperating gains (losses) consist primarily of income on invested funds, gains and losses on sales of securities, changes in unrestricted unrealized gains and losses and unrestricted gifts and bequests.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Start up costs of \$202,579 related to investments in medical practices are included with other nonoperating expenses in the consolidated statements of operations and changes in net assets for the year ended September 30, 2011, as these costs did not meet the criteria for capitalization and were considered nonoperating due to the fact that the expenses related to investing activities rather than providing health care services.

EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES

The statements of operations and changes in net assets include the excess (deficiency) of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from the excess (deficiency) of revenues over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), pension liability adjustments, and interest rate swap adjustments.

Operations improvement expenses represent consulting and other costs incurred by the Hospital in 2011 to improve the revenue cycle, increase cash flows, and improve the Hospital's overall financial performance. These costs did not recur in 2012.

INCOME TAXES

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Hospital is also exempt from state income taxes. Access, GWIC, CAGW, and Imaging Partners LLC are partnerships. For tax purposes, these partnerships are pass-through entities. Taxation does not occur at the partnership level. Accordingly, no provision for taxes is included. AMG is tax exempt under Section 501 (c)(3) of the code.

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

MEDICAL MALPRACTICE AND WORKERS' COMPENSATION INSURANCE

The Hospital has a policy of self-insuring the deductible portion of its workers' compensation claims. The deductible limit is \$400,000 per claim. The Hospital maintains a letter of credit with a bank in support of its self-insured workers' compensation program. This letter of credit limit was \$3.5 million at September 30, 2012 and 2011. Management records its best estimate of losses as they occur. The accrued workers' compensation self-insurance liabilities of \$9,871,633 and \$7,763,172 at September 30, 2012 and 2011, respectively, have been discounted 2.25%.

Effective October 1, 2006, the Hospital obtained "claims-made" medical malpractice insurance coverage, through the Network, from Healthcare Alliance Insurance Company, Ltd. (HAIC). HAIC is a multi-provider captive insurance company domiciled in the Cayman Islands. The Network is a one third owner of the HAIC with two other local hospitals that each hold one third ownership. The Hospital's insurance coverage is \$1,500,000 per occurrence and \$5,000,000 in the aggregate. In addition to the coverage from HAIC, the Hospital recorded reserves of approximately \$2,104,554 and \$2,174,777 at September 30, 2012 and 2011, respectively, related to claims that were incurred subsequent to October 1, 2006, but not yet reported. These reserves were discounted at 2.25% at September 30, 2012 and 2011.

The Hospital also obtains excess insurance coverage for professional and general liability, through the Network, from HAIC. These policies have limits of \$25,000,000 per claim and \$25,000,000 aggregate, in excess of the underlying limits in the primary layer, for both professional and general liability.

The Hospital also purchased a loss transfer insurance policy which provides \$1,000,000 of coverage for each medical incident that was incurred between October 1, 2003 and October 1, 2006 and specifically reported to the insurance company on the effective date of the transfer policy (February 7, 2008) in addition to medical incidents incurred during the aforementioned period which are first reported after the effective date of the policy. This policy also provides \$1,000,000 of coverage for general liability incurred but not reported claims that occurred after October 1, 2003 through October 1, 2006 and were first reported after the effective date of the policy.

The policy has annual aggregate limits of \$4,500,000 for medical incidents and \$3,000,000 for general liability cases with a combined \$25,000,000 total limit for all policy years. These aggregate limits are eroded by claims previously paid by the Hospital or other insurance.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

RETIREMENT BENEFIT PLANS

The Hospital maintains a defined benefit pension plan for eligible individuals. Reference is made to Note 9.

RISKS AND UNCERTAINTIES

The Hospital invests in a variety of investment securities which are exposed to various risks, such as interest rate risk, financial market risk, currency risk and credit risk. Due to the level of risk associated with investment securities, coupled with the economic events, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the Hospital's September 30, 2012 financial statements, in addition to the funded status of its defined benefit pension plan.

NEW ACCOUNTING PRONOUNCEMENTS

PRESENTATION OF INSURANCE CLAIMS AND RELATED INSURANCE RECOVERIES

Effective October 1, 2011 and retrospectively for all periods presented, the Hospital adopted the provisions of ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*, which further clarifies that health care entities should not net insurance recoveries against the related claim liabilities. In connection with the Hospital's adoption of ASU 2010-24, the Hospital recorded increases of \$1,761,666 to grants and other receivables and accounts payable and accrued expenses in the accompanying consolidated balance sheet as of September 30, 2011. The increase as of September 30, 2011 represents the Hospital's workers' compensation claims covered by insurance for losses in excess of the deductible under the Hospital's insurance policy.

The adoption of ASU 2010-24 had no impact on net assets or the excess (deficiency) of revenues over expenses.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

MEASURING CHARITY CARE FOR DISCLOSURE

Self-pay revenues are derived primarily from patients who do not have any form of health care coverage. The revenues associated with self-pay patients are generally reported at the Hospital's gross charges. The Hospital evaluates these patients, after the patient's medical condition is determined to be stable, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid or other governmental assistance programs, as well as the Hospital's policy for charity care. The Hospital provides care without charge to certain patients that qualify under its charity care policy. For the years ended September 30, 2012 and 2011, the Hospital estimates that its costs of care provided under its charity care programs approximated \$369,888 and \$806,987, respectively.

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

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

BAD DEBTS

In July 2011, the FASB issued ASU 2011-07, *Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts*, which requires health care entities to present the bad debt expense associated with patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) rather than as an operating expense with enhanced footnote disclosures on the policies for recognizing revenue and assessing bad debts, in addition to qualitative and quantitative information about changes in the allowance for doubtful accounts. The pronouncement will be adopted during the fiscal year ending September 30, 2013. The Hospital is evaluating the effect of the pronouncement on its financial statements.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

The American Recovery and Reinvestment Act of 2009 (ARRA) included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive payment program for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are also available to providers that adopt, implement or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

Income from Medicare incentive payments is recognized as revenue after the Hospital has demonstrated that it complied with the meaningful use criteria over the entire applicable compliance period. The Hospital recognized revenue from Medicaid incentive payments after it adopted certified EHR technology. Incentive payments totaling \$3,392,498 for the year ended September 30, 2012, are included in other operating revenues in the accompanying consolidated statements of operations and changes in net assets. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using Medicare cost report data that is subject to audit. Additionally, the Hospital's compliance with the meaningful use criteria is subject to audit by the federal government.

PRIOR PERIOD ADJUSTMENTS

During 2012, the Hospital determined that inventory of certain departments, previously believed to be immaterial, should be recorded. In order for the financial statements to be comparative, the Hospital recorded a \$2,400,000 increase to the inventory balance previously recorded in the September 30, 2011 balance sheet.

During 2012, the Hospital also determined that patient accounts receivable was overstated by \$5,160,000 as of September 30, 2010 and bad debt expense was understated by \$2,210,000 for the year ended September 30, 2011, primarily resulting from patient accounts receivable balances due from workers' compensation insurance companies and self-pay patients.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Corrections of these errors have been reflected in the accompanying consolidated financial statements as follows:

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total Net Assets Excluding Noncontrolling Interests
Previously reported net assets excluding noncontrolling interests at September 30, 2010	\$ 45,216,062	\$ 8,315,873	\$ 42,353,101	\$ 95,885,036
Adjustment to decrease accounts receivable	(5,160,000)	--	--	(5,160,000)
Adjustment to increase inventory	<u>2,400,000</u>	<u>--</u>	<u>--</u>	<u>2,400,000</u>
Restated net assets excluding noncontrolling interests at September 30, 2010	<u>42,456,062</u>	<u>8,315,873</u>	<u>42,353,101</u>	<u>93,125,036</u>
Previously reported decrease in net assets, controlling interest, for the year ended September 30, 2011	(11,483,058)	(1,838,419)	(2,221,826)	(15,543,303)
Adjustment to increase 2011 bad debt expense	<u>(2,210,000)</u>	<u>--</u>	<u>--</u>	<u>(2,210,000)</u>
Restated decrease in net assets, controlling interest, for the year ended September 30, 2011	<u>(13,693,058)</u>	<u>(1,838,419)</u>	<u>(2,221,826)</u>	<u>(17,753,303)</u>
Restated net assets excluding noncontrolling interests at September 30, 2011	<u>\$ 28,763,004</u>	<u>\$ 6,477,454</u>	<u>\$ 40,131,275</u>	<u>\$ 75,371,733</u>

The following summarizes the effect of the error corrections on the September 30, 2011 consolidated balance sheet:

	Previously Reported	Restated
Patient accounts receivable, net of allowance	\$ 36,400,710	\$ 29,030,710
Inventories of supplies	858,762	3,258,762

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 2 – REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE

The following table summarizes net revenues from services to patients:

	2012	2011
Gross revenues from services to patients	<u>\$ 966,591,489</u>	<u>\$ 897,402,505</u>
Deductions (additions)		
Allowances	698,910,302	634,142,056
Regulatory	<u>(1,431,356)</u>	<u>(2,602,411)</u>
	<u>697,478,946</u>	<u>631,539,645</u>
Net revenues from services to patients	<u>\$ 269,112,543</u>	<u>\$ 265,862,860</u>

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

Amounts received from most payors are different from the established billing rates of the Hospital, and these differences are accounted for as allowances. Net revenues have been affected by the State of Connecticut Disproportionate Share program in 2012 and 2011 which is reflected in the regulatory amounts in the table above.

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. For the years ended September 30, 2012 and 2011, the Hospital recorded approximately \$2,066,000 and \$3,900,000, respectively, as an increase to net revenues from services to patients as changes in estimates related to third-party payor settlements and adjustments to accruals recorded in prior years.

During 2012 and 2011, approximately 43% and 45%, respectively, of net revenue from services to patients was received under the Medicare program, 11% and 14%, respectively, under the state Medicaid program, and 41% and 35%, respectively, from contracts with other third-parties.

Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital. The State of Connecticut has announced reductions in the State's Disproportionate Share Reimbursement Program for fiscal year 2013. Based on estimates provided by the State, these reductions will reduce net patient service revenue by approximately \$1,300,000 during the year ending September 30, 2013.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 2 – REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE (CONTINUED)

The significant concentrations of net accounts receivable for services to patients include 47% from Medicare, 13% from Medicaid, 25% from commercial insurance carriers and 15% from others at September 30, 2012 (42%, 16%, 27% and 15%, respectively, in 2011).

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Hospital believes that it is in compliance with all applicable laws and regulations. Cost reports for the Hospital, which serve as a basis for final settlement with government payors, have been settled by final settlement through 2006 for Medicare and 1995 for Medicaid. Other years remain open for settlement.

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

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 3 – INVESTMENTS

The composition of investments, including other assets and funds held in escrow is set forth in the following table. Investments are stated at fair value:

	2012		2011	
	Cost	Fair Value	Cost	Fair Value
Escrow funds for long-term debt:				
Cash and money market funds	\$ 661,338	\$ 661,338	\$ 3,958,301	\$ 3,958,301
	<u>\$ 661,338</u>	<u>\$ 661,338</u>	<u>\$ 3,958,301</u>	<u>\$ 3,958,301</u>
Investments of funds held in trust by others	<u>\$ 35,730,956</u>	<u>\$ 42,218,163</u>	<u>\$ 35,350,210</u>	<u>\$ 37,339,264</u>
Long-term investments and Board-designated funds:				
Certificates of deposit and money market funds	\$ 854,843	\$ 854,843	\$ 679,841	\$ 679,841
Marketable equity securities	73,305	116,299	23,464	72,852
U.S. Government obligations	108,451	169,163	108,451	168,683
Corporate bonds	3,386,725	3,548,495	3,217,875	3,147,411
Mutual funds	<u>7,626,076</u>	<u>7,904,439</u>	<u>7,968,107</u>	<u>6,984,013</u>
	<u>\$ 12,049,400</u>	<u>\$ 12,593,239</u>	<u>\$ 11,997,738</u>	<u>\$ 11,052,800</u>

The Hospital had long-term investments in partnerships and joint ventures that were recorded at cost of \$382,976 and \$322,836 as of September 30, 2012 and 2011, respectively, as it was not practicable to estimate fair value.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 3 – INVESTMENTS (CONTINUED)

Unrestricted investment income, including income on funds held in trust by others, and gains and (losses) are comprised of the following for the years ended September 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Income		
Investment income	\$ 1,607,608	\$ 1,682,054
Changes in net unrealized gains (losses) on investments	<u>392,543</u>	<u>(529,738)</u>
	<u>\$ 2,000,151</u>	<u>\$ 1,152,316</u>

A summary of interest cost and investment income on borrowed funds held by the trustee under revenue bond indentures during the years ended September 30, 2012 and 2011 follows:

	<u>2012</u>	<u>2011</u>
Interest charged to operations	<u>\$ 929,633</u>	<u>\$ 945,210</u>
Investment income credited to other operating revenues	<u>\$ 233</u>	<u>\$ 26,989</u>

NOTE 4 – FAIR VALUE MEASUREMENTS

The Hospital categorizes assets and liabilities for disclosure purposes based on whether the inputs used to determine their fair values are observable or unobservable. The Hospital utilizes a three-level fair value hierarchy that prioritizes the inputs used to measure assets at fair value. Level inputs are as follows:

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

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

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 4 – FAIR VALUE MEASUREMENTS (CONTINUED)

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

The fair value of the interest rate swap was determined by the counterparty based on an estimate of the net present value of the expected cash flows using relevant mid-market data inputs and based on the assumption of no unusual market conditions or forced liquidation.

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

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 31,686,030	\$ --	\$ --	\$ 31,686,030
Common stock-Insurance	64,739	--	--	64,739
Mutual funds:				
U.S. large cap	19,580,267	--	--	19,580,267
U.S. mid cap	2,972,585	--	--	2,972,585
U.S. small cap	2,025,227	--	--	2,025,227
International developed	4,210,680	--	--	4,210,680
Emerging markets	2,394,768	--	--	2,394,768
Bonds	345,802	--	--	345,802
Fixed income securities:				
Investment grade taxable	2,293,528	10,423,958	--	12,717,486
International developed bonds	--	632,249	--	632,249
Global high yield taxable	399,340	2,977,811	--	3,377,151
U.S. Government obligations	1,276,960	--	--	1,276,960
Mortgage backed securities	--	873,732	--	873,732
Real estate investment trusts	1,844,055	--	--	1,844,055
Other	38,500	--	--	38,500
Total investments at fair value	<u>\$ 69,132,481</u>	<u>\$ 14,907,750</u>	<u>\$ --</u>	<u>\$ 84,040,231</u>
Liabilities:				
Interest rate swap	<u>\$ --</u>	<u>\$ 2,938,962</u>	<u>\$ --</u>	<u>\$ 2,938,962</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 4 – FAIR VALUE MEASUREMENTS (CONTINUED)

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

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 21,581,247	\$ --	\$ --	\$ 21,581,247
Common stock-Insurance	72,852	--	--	72,852
Mutual funds:				
U.S. large cap	18,394,401	--	--	18,394,401
U.S. mid cap	2,815,051	--	--	2,815,051
U.S. small cap	1,771,662	--	--	1,771,662
International developed	3,671,285	--	--	3,671,285
Emerging markets	1,841,832	--	--	1,841,832
Bonds	451,851	--	--	451,851
Fixed income securities:				
Investment grade taxable	2,720,140	10,381,908	--	13,102,048
International developed bonds	5,829	638,299	--	644,128
Global high yield taxable	237,905	1,794,477	--	2,032,382
U.S. Government obligations	168,683	--	--	168,683
Mortgage backed securities	--	863,883	--	863,883
Real estate investment trusts	598,921	137,515	--	736,436
Other	15,224	--	--	15,224
Total investments at fair value	<u>\$ 54,346,883</u>	<u>\$ 13,816,082</u>	<u>\$ --</u>	<u>\$ 68,162,965</u>
Liabilities:				
Interest rate swap	<u>\$ --</u>	<u>\$ 2,414,415</u>	<u>\$ --</u>	<u>\$ 2,414,415</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 5 – RESTRICTED ENDOWMENTS

The Hospital's endowments consist of donor-restricted endowment funds and Board designated endowment funds. Net assets associated with endowment funds are classified and reported based on donor-imposed restrictions.

The Hospital's Board of Trustees has interpreted the Connecticut Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and, if applicable (c) accumulations to the permanent endowment made in accordance with the related gift's donor instructions. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard for expenditure as proscribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making determinations to appropriate or accumulate donor-restricted endowment funds:

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

RETURN OBJECTIVES AND RISK PARAMETERS

For the permanently restricted endowment funds, the bank, acting in its capacity as trustee, determines and directs the investment policy and asset allocation. For the unrestricted and temporarily restricted endowment funds, the Hospital's Board of Trustees has adopted investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. The Hospital expects these endowment funds, over time, to provide an average rate of return that exceeds the rate of inflation by 3.5% annually. Actual returns in any given year may vary from this amount.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 5 – RESTRICTED ENDOWMENTS (CONTINUED)

STRATEGIES EMPLOYED FOR ACHIEVING OBJECTIVES

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

SPENDING POLICY AND HOW THE INVESTMENT OBJECTIVES RELATE TO SPENDING POLICY

The Hospital has a policy of evaluating the spending decisions for each endowment fund based upon the intentions of the donors and specific contractual agreements. In determining the annual amount to be spent, the Hospital considers the long-term expected return on its endowment. The spending policy is designed to limit spending to the expected long-term real rate of return. The annual distribution from the endowment funds is expected to be contained within a range of 4-6% of the trusts' market value. This is consistent with the Hospital's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

ENDOWMENT NET ASSET COMPOSITION BY TYPE OF FUND AS OF SEPTEMBER 30, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ --	\$ 6,806,683	\$ 45,010,199	\$ 51,816,882
Board-designated endowment funds	<u>2,974,503</u>	<u>--</u>	<u>--</u>	<u>2,974,503</u>
	<u>\$ 2,974,503</u>	<u>\$ 6,806,683</u>	<u>\$ 45,010,199</u>	<u>\$ 54,791,385</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 5 – RESTRICTED ENDOWMENTS (CONTINUED)

CHANGES IN ENDOWMENT NET ASSETS FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning balance	\$ 2,615,009	\$ 5,696,591	\$ 40,131,275	\$ 48,442,875
Investment return				
Investment income	72,000	259,851	--	331,851
Net appreciation (realized and unrealized)	<u>406,963</u>	<u>1,266,934</u>	<u>4,878,924</u>	<u>6,552,821</u>
Total investment return	478,963	1,526,785	4,878,924	6,884,672
Appropriation of endowment assets for expenditure	<u>(119,469)</u>	<u>(416,693)</u>	--	<u>(536,162)</u>
Endowment net assets, ending balance	<u>\$ 2,974,503</u>	<u>\$ 6,806,683</u>	<u>\$ 45,010,199</u>	<u>\$ 54,791,385</u>

ENDOWMENT NET ASSET COMPOSITION BY TYPE OF FUND AS OF SEPTEMBER 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ --	\$ 5,696,591	\$ 40,131,275	\$ 45,827,866
Board-designated endowment funds	<u>2,615,009</u>	--	--	<u>2,615,009</u>
	<u>\$ 2,615,009</u>	<u>\$ 5,696,591</u>	<u>\$ 40,131,275</u>	<u>\$ 48,442,875</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 5 – RESTRICTED ENDOWMENTS (CONTINUED)

CHANGES IN ENDOWMENT NET ASSETS FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning balance	\$ 2,787,502	\$ 6,317,021	\$ 42,353,101	\$ 51,457,624
Investment return				
Investment income (loss)	70,866	(175,906)	--	(105,040)
Net depreciation (realized and unrealized)	<u>(119,892)</u>	<u>(338,055)</u>	<u>(2,221,826)</u>	<u>(2,679,773)</u>
Total investment return	(49,026)	(513,961)	(2,221,826)	(2,784,813)
Appropriation of endowment assets for expenditure	<u>(123,467)</u>	<u>(106,469)</u>	--	<u>(229,936)</u>
Endowment net assets, ending balance	<u>\$ 2,615,009</u>	<u>\$ 5,696,591</u>	<u>\$ 40,131,275</u>	<u>\$ 48,442,875</u>

NOTE 6 – TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets at September 30, 2012 and 2011, are restricted amounts which are to be held in perpetuity, the income from which is expendable to provide free care, scholarships for the children of the Hospital's employees, and for the operations of the Hospital. Also included in permanently restricted net assets are funds held in trust by others. The Hospital is the restricted income beneficiary of funds held in trust by others. The total trust assets, as reported by the trustee, had an aggregate fair value at September 30, 2012 and 2011 of \$42,218,163 and \$37,339,264, respectively. Income of \$1,759,075 and \$1,742,185 earned on these assets for the years ended September 30, 2012 and 2011, respectively, is included in investment income.

Temporarily restricted net assets are available to provide psychiatric services, free care and educational seminars.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 6 – TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (CONTINUED)

During 2011, net assets were released from donor restrictions by incurring expenses which satisfied the restricted purposes in providing grant related services, free care, and various miscellaneous services in the amounts of \$4,733,897, \$625,195, and \$249,913, respectively in 2012 and \$4,709,075, \$695,241, and \$515,229, respectively in 2011. In addition, \$134,036 and \$1,207,613 were released for the purchase of property and equipment in 2012 and 2011, respectively.

NOTE 7 - DEBT

SERIES C AND D BOND FINANCING

On December 1, 1999, the Hospital entered into Series C financing arrangements with CHEFA under a Master Indenture for the financing of, among other things, renovations, equipment purchases or replacements, and the defeasance of the Series B Bonds. To finance the above, CHEFA sold \$27,140,000 of Series C revenue bonds with interest at a net average annual rate of approximately 5.48%.

Under the terms of the financing arrangements between the Hospital and CHEFA, the proceeds of the revenue bonds were loaned to the Hospital. Pursuant to the loan agreement, the Hospital was obligated to provide amounts which will be sufficient to enable CHEFA to pay the principal of and interest on the proceeds of the Series C Bonds.

Concurrently with the issuance and delivery of the Series C Bonds, the Hospital and U.S. Bank NA, as Trustee, entered into the Master Indenture and Supplemental Master Indenture Number 1 pursuant to which the Hospital was obligated to pay the amount due under the loan agreement with CHEFA. The Master Indenture and Supplemental Master Indenture provided for, among other things, the establishment and maintenance of a Debt Service Reserve Fund and a pledge of the gross receipts, as defined, of the Hospital, restriction on the incurrence of certain indebtedness of the Hospital and provided for covenants regarding the Hospital's debt service coverage ratios, minimum levels of cash on hand, the ratio of long term debt to total capitalization, sale and lease of assets and other covenants similar in financings of this type.

In December 2010, the Hospital refinanced its Series C bond financing and financed an additional \$8,000,000 for various capital projects to be completed over a two year period. The par amount of the new Series D debt was \$25,918,000 and interest is variable at the interest rate that is equal to the product of (i) sixty-eight percent (68%) and (ii) the sum of the LIBOR Rate and three hundred basis points (2.19% at September 30, 2012). The new bonds require monthly principal and interest payments, based upon a 10 year amortization schedule, from 2011 through 2020 with the remaining principal balance due in 2020.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 7 – DEBT (CONTINUED)

The terms of the bonds provide for, among other things, a pledge of gross receipts of the Hospital, restriction on the incurrence of certain indebtedness of the Hospital and provide for covenants regarding the Hospital's debt service coverage ratios, minimum levels of cash on hand, sale and lease of assets and other covenants similar in financings of this type.

In connection with this refinancing, the Hospital entered into an interest rate swap with a bank which allowed it to convert its variable interest rate liability to a fixed interest rate liability of 4.475% without changing the structure of the underlying debt.

The Hospital uses the interest rate swap agreement to manage interest rate risk associated with its outstanding debt. At September 30, 2012 and 2011, the notional value of outstanding interest rate swap was \$25,207,100 and \$25,630,879, respectively.

The Hospital recognizes the fair value of its interest rate swap in the consolidated balance sheet as a liability, recorded in other noncurrent liabilities. At September 30, 2012 and 2011, the fair value of interest rate swap was in a liability position of \$2,938,962 and \$2,414,415, respectively.

The Hospital designated its interest rate swap as a cash flow hedge for accounting purposes, and accordingly defers gains or losses associated with the swap in net assets.

Future minimum payments by year and in the aggregate under the Series D bond financing are as follows at September 30, 2012:

2013	\$	451,444
2014		472,136
2015		493,776
2016		516,408
2017		540,080
Aggregate thereafter		<u>22,733,256</u>
	\$	<u>25,207,100</u>

Access has a \$250,000 line of credit with a bank. There were no borrowings under this line of credit at September 30, 2012 and 2011.

The Hospital had a \$3.5 million letter of credit with a bank available at September 30, 2012 and September 30, 2011 to support its self-insured workers' compensation program that is collateralized by certain investments held by the bank. As of September 30, 2012 and 2011, there were no borrowings on this letter of credit.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 7 – DEBT (CONTINUED)

Imaging Partners, LLC entered into a master equipment lease during 2006. The lease calls for unequal periodic payments through October 2011 and is secured by the equipment. The balance of the capital lease liability was \$0 at September 30, 2012 and \$20,318 at September 30, 2011.

AMG has a capital lease for equipment that calls for monthly payments of \$1,485 through April 2013 and is secured by the equipment. The balance of the capital lease liability was \$10,054 at September 30, 2012 and \$25,987 at September 30, 2011.

AMG has a capital lease for equipment that calls for monthly payments of \$593 through January 2014 and is secured by the equipment. The balance of the capital lease liability was \$9,037 at September 30, 2012 and \$14,365 at September 30, 2011.

AMG entered into an equipment lease during 2010. The lease calls for monthly payments of \$353 through March 2015 and is secured by the equipment. The balance of the capital lease liability was \$9,445 at September 30, 2012 and \$12,724 at September 30, 2011.

AMG entered into an equipment lease during 2010. The lease calls for monthly payments of \$447 through May 2015 and is secured by the equipment. The balance of the capital lease liability was \$13,095 at September 30, 2012 and \$17,140 at September 30, 2011.

The Hospital entered into a capital lease for equipment during 2011. The lease calls for equal monthly payments of \$20,885 through May 2016 and is secured by the equipment. The balance of the capital lease liability was \$835,685 at September 30, 2012 and \$1,048,436 at September 30, 2011.

The Hospital entered into a capital lease for equipment during 2011. The lease calls for equal monthly payments of \$14,031 through July 2013 and is secured by the equipment. The balance of the capital lease liability was \$137,403 at September 30, 2012 and \$295,505 at September 30, 2011.

AMG entered into a term note during 2010 at an interest rate of 9.8%. The note calls for monthly payments of \$13,216 through November 2014 and is secured by the assets of AMG. The balance of the term note liability was \$307,277 at September 30, 2012 and \$427,917 at September 30, 2011.

AMG assumed a note payable during 2009 for the fit-up of office space. The original amount of the note was \$320,000 and is repayable in installments of principal plus interest at 7.50% totaling \$4,908 per month through January 2014. In addition, this note calls for a final payment of principal and interest of \$113,981 in February 2014. The balance of this note was \$177,038 at September 30, 2012 and \$220,858 at September 30, 2011.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 7 – DEBT (CONTINUED)

The Hospital entered into a capital lease for equipment during 2012. The lease calls for equal monthly payments of \$11,469 through August 2017 and is secured by the equipment. The balance of the capital lease liability was \$593,633 at September 30, 2012.

Future minimum payments by year and in the aggregate for all obligations other than the CHEFA Series D bonds were as follows at September 30, 2012:

2013	\$	666,376
2014		633,406
2015		395,685
2016		273,670
2017		<u>123,530</u>
	\$	<u>2,092,667</u>

The fair value of the debt, using the discounted cash flow analyses, was approximately \$29,240,000 at September 30, 2012 and \$27,700,000 at September 30, 2011.

NOTE 8 – RENTAL EXPENSE AND LEASE COMMITMENTS

The Hospital has entered into operating leases for office space and office equipment. Rental expense for the years ended September 30, 2012 and 2011 was \$4,586,155 and \$4,199,924, respectively. The minimum rental commitments under all noncancellable operating leases with initial or remaining terms of more than one year are as follows:

2013	\$	4,069,370
2014		4,016,077
2015		3,302,125
2016		3,172,341
2017		2,459,221
Thereafter		<u>1,748,046</u>
	\$	<u>18,767,180</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 9 – EMPLOYEE BENEFIT PLANS

The Hospital has a noncontributory defined benefit cash balance plan (the Plan). Under the Plan, each participant who elected to transfer their balances to the Plan from the former defined contribution plan receives a credit of 6% of compensation allocated to their cash balance accounts. All other participants receive a 3% credit. Additionally, each participant receives an interest credit to their cash balance account based on the yield to maturity on three-year treasury bills. The Plan covers substantially all non-union employees age 21 and older with one year of service. It is the Hospital's policy to make contributions to the Plan sufficient to meet the minimum funding requirements of applicable laws and regulations.

Following is a summary of the Plan's funded status using the measurement dates of September 30, 2012 and 2011 and amounts recognized in the Hospital's consolidated financial statements.

	2012	2011
Change in benefit obligation		
Benefit obligation beginning of year	\$ (37,373,483)	\$ (37,725,464)
Service cost	(1,220,226)	(1,212,075)
Interest cost	(1,798,078)	(1,740,830)
Actuarial (loss) gain	(443,054)	311,362
Benefits paid	2,946,016	2,993,524
Benefit obligation, end of year	\$ (37,888,825)	\$ (37,373,483)
Change in plan assets		
Fair value of plan assets, beginning of year	\$ 26,540,513	\$ 28,672,719
Actual return on plan assets	2,716,897	79,583
Employer contributions	2,531,719	781,735
Benefits paid	(2,946,016)	(2,993,524)
Fair value of plan assets, end of year	\$ 28,843,113	\$ 26,540,513
Funded status	\$ (9,045,712)	\$ (10,832,970)
Accrued pension liability	\$ (9,045,712)	\$ (10,832,970)

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

Components of net periodic pension cost

Service cost	\$ 1,220,226	\$ 1,212,075
Interest cost	1,798,078	1,740,830
Expected return on plan assets	(2,566,157)	(2,674,199)
Amortization of actuarial loss	623,556	431,281
Amortization of prior service cost	<u>35,527</u>	<u>35,527</u>
Net periodic pension cost	<u>\$ 1,111,230</u>	<u>\$ 745,514</u>
Accumulated benefit obligation	<u>\$ 36,832,025</u>	<u>\$ 35,847,835</u>

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

	2012	2011
Unrecognized prior service cost	\$ (191,986)	\$ (227,513)
Unrecognized actuarial losses	<u>(15,640,839)</u>	<u>(15,972,081)</u>
Benefit obligation, end of year	<u>\$ (15,832,825)</u>	<u>\$ (16,199,594)</u>

Changes in benefit obligations recognized in unrestricted net assets include:

	2012	2011
Current year actuarial losses	\$ (292,314)	\$ (2,283,254)
Amortization of prior service cost	35,527	35,527
Amortization of net loss	<u>623,556</u>	<u>431,281</u>
	<u>\$ 366,769</u>	<u>\$ (1,816,446)</u>

The prior service cost and actuarial losses included in unrestricted net assets and expected to be recognized in net periodic cost during the year ending September 30, 2013 are \$35,527 and \$918,715, respectively.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

ASSUMPTIONS

The weighted-average assumptions used to determine benefit obligations at September 30 are as follows:

	2012	2011
Discount rate	3.17%	5.07%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	2% for 4 year select period, 3% ultimate	2% for 5 year select period, 3% ultimate

The weighted-average assumptions used to determine net periodic benefit cost for years ended September 30 are as follows:

	2012	2011
Discount rate	5.07%	4.83%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	2.00% for 5 year select period, 3.00% ultimate	2.00% for 5 year select period, 3.00% ultimate

EXPECTED LONG-TERM RETURN ON PLAN ASSETS

To develop the expected long-term rate of return on assets assumptions, the Hospital considered the historical returns and the future expectations of returns for each asset class, as well as target asset allocations of the pension portfolio. This resulted in the selection of the 8.0% long-term rate of return.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

INVESTMENT POLICY

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

Asset Category	Plan Assets at September 30		Asset Allocation Policy	
	2012	2011	Target	Range
Equity securities	44%	40%	45%	40% -50%
Debt securities	33%	36%	35%	25% -45%
Multi-strategy hedge fund of funds	20%	21%	20%	15% -25%
Cash and cash equivalents	3%	3%		

The Pension Committee of the Board of Trustees (the Committee) is responsible for employee benefit program policies with respect to plan assets and the retention of qualified managers, consultants and trustee/custodians. The purpose of the Committee is to ensure the Plan assets accumulate monies required to meet the anticipated benefit payments of the Plan; contributions are made by the Hospital on a basis determined by the Plan's actuary to be adequate to fund the benefits. The investment objective of the Committee is to maximize total return after inflation within the limits of prudent risk taking by diversifying across asset classes and multiple managers. The Committee has established an asset allocation policy that sets a target and range for each asset class, as shown in the table above.

CONTRIBUTIONS

The Hospital expects to make \$1,800,000 in contributions to the Plan in 2013.

ESTIMATED FUTURE BENEFIT PAYMENTS

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

2013	\$ 3,139,000
2014	3,103,000
2015	2,827,000
2016	3,171,000
2017	3,046,000
2018-2022	<u>13,327,000</u>
	<u>\$ 28,613,000</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

As required by ASC 820, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

The following tables set forth by level within the fair value hierarchy the investment assets and investment liabilities at fair value, as of September 30, 2012.

	Level 1	Level 2	Level 3	Total
Equities	\$ 1,450,511	\$ --	\$ --	\$ 1,450,511
Commingled funds and private equity	--	--	19,307,214	19,307,214
U.S. Government obligations	4,463,951	--	--	4,463,951
Corporate bonds	--	3,210,511	--	3,210,511
Distribution receivable	363,345	--	--	363,345
Interest and dividends	47,581	--	--	47,581
	<u>\$ 6,325,388</u>	<u>\$ 3,210,511</u>	<u>\$ 19,307,214</u>	<u>\$ 28,843,113</u>

The following tables set forth by level within the fair value hierarchy the investment assets and investment liabilities at fair value, as of September 30, 2011.

	Level 1	Level 2	Level 3	Total
Equities	\$ 1,222,719	\$ --	\$ --	\$ 1,222,719
Commingled funds and private equity	--	--	17,038,042	17,038,042
U.S. Government obligations	3,807,059	--	--	3,807,059
Corporate bonds	--	3,804,741	--	3,804,741
Distribution receivable	610,079	--	--	610,079
Interest and dividends	57,873	--	--	57,873
	<u>\$ 5,697,730</u>	<u>\$ 3,804,741</u>	<u>\$ 17,038,042</u>	<u>\$ 26,540,513</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

The following is a reconciliation of Level 3 assets, collective investments and common trust funds, for which significant unobservable inputs were used to determine fair value:

	2012	2011
Balance as of September 30,	\$ 17,038,042	\$ 12,956,286
Change in unrealized appreciation (depreciation)	2,362,257	(1,081,776)
Purchases	7,446,351	18,117,388
Sales	<u>(7,539,436)</u>	<u>(12,953,856)</u>
Balance as of September 30,	<u>\$ 19,307,214</u>	<u>\$ 17,038,042</u>

OTHER BENEFIT PLANS

The Hospital also makes contributions for substantially all union employees to pension plans sponsored by the union. Contributions are based on a percentage of each participant's total salary. The Hospital is exploring the costs to withdraw from the union pension plans in the event that the Hospital enters into a joint venture (Refer to Note 14). Management does not have an estimate of such costs, however, the maximum cost would not exceed 20 years of the annual premium amounts.

Total pension expense charged to operations for the Plan and the union pension plans during the years ended September 30, 2012 and 2011 was \$3,876,970 and \$3,917,189, respectively.

In addition, the Hospital has a supplemental employee retirement plan for certain executives. The plan provides for a total benefit and is partially funded. As of September 30, 2012 and 2011, liabilities of \$152,244 and \$76,031, respectively, have been reflected in the consolidated balance sheets.

NOTE 10 – SELF-INSURANCE CLAIMS

There have been medical malpractice and workers' compensation claims that fall within the Hospital's partially self-insured program, which have been asserted against the Hospital. In addition, there are known incidents that have occurred through September 30, 2012 that may result in the assertion of claims. Hospital management has accrued its best estimate of these contingent losses. Other claims may be asserted arising from services provided to patients or workers' compensation incidents in the past. Hospital management has provided reserves for these contingent liabilities.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 11 – CONTINGENCIES

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

NOTE 12 – DUE (TO) FROM AFFILIATES

The amounts due (to) from affiliates of \$(2,999,940) and \$3,848,949 at September 30, 2012 and 2011, respectively, represent receivables from and (payables) to affiliates that do not eliminate in consolidation. These balances are comprised of the following:

	2012	2011
Greater Waterbury Health Network, Inc.	\$ (2,828,764)	\$ 4,020,125
Alliance Medical Group of Greater Waterbury, P.C.	(9,983)	(9,983)
Greater Waterbury Management Resources, Inc.	(162,693)	(162,693)
GI Co-Management Company	1,500	1,500
	<u>\$ (2,999,940)</u>	<u>\$ 3,848,949</u>

NOTE 13 – FUNCTIONAL EXPENSES

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

	2012	2011
Health care services	\$ 213,787,979	\$ 208,141,309
General and administrative	66,059,047	76,707,776
Fundraising	256,714	326,755
	<u>\$ 280,103,740</u>	<u>\$ 285,175,840</u>

NOTE 14 – SUBSEQUENT EVENTS

The Hospital evaluates the impact of subsequent events, events that occur after the balance sheet date but before the financial statements are issued, for potential recognition in the financial statements as of the balance sheet date or for disclosure in the notes to the financial statements. The Hospital evaluated events occurring subsequent to September 30, 2012 through January 28, 2013, the date on which the accompanying consolidated financial statements were available to be issued. During this period, there were no subsequent events that required recognition in the consolidated financial statements.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

NOTE 14 – SUBSEQUENT EVENTS (CONTINUED)

On October 29, 2012, the Network entered into a nonbinding letter of intent with Vanguard Health Systems, Inc. (Vanguard) to form a joint venture with a subsidiary of Vanguard. This joint venture would own and operate most of the assets of the Network. The obligations of the parties to close the transaction will be subject to the negotiation of definitive agreements, the receipt of all required regulatory approvals, licenses and permissions, the lack of a material adverse change to the condition or results of operations of the Network, the solvency of the parties and other customary closing obligations.

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

Board of Trustees
The Waterbury Hospital

Our report on our audits of the basic consolidated financial statements of The Waterbury Hospital as of and for the years ended September 30, 2012 and 2011 appears on page 1. Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The following consolidating information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Marcum LLP

Hartford, CT
January 28, 2013

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2012

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Assets								
Current Assets								
Cash and cash equivalents	\$ 22,930,963	\$ 1,688,371	\$ 2,353,527	\$ 279,212	\$ 664,318	\$ 202,782	\$ --	\$ 28,119,173
Short-term investments	--	--	448,318	--	--	--	--	448,318
Patient accounts receivable, net	26,903,888	757,059	1,821,440	43,622	2,195,621	420,152	(369,806)	31,771,976
Grants and other receivables	2,829,816	--	--	--	223,046	201,111	(276,469)	2,977,504
Inventories of supplies	3,105,602	--	--	--	199,477	--	--	3,305,079
Prepaid insurance and other expenses	1,109,204	--	100,122	5,106	156,561	122,519	--	1,493,512
Total Current Assets	\$ 56,879,473	\$ 2,445,430	\$ 4,723,407	\$ 327,940	\$ 3,439,023	\$ 946,564	\$ (646,275)	\$ 68,115,562
Other Assets								
Funds held in escrow by agreement with the State of Connecticut Health and Educational Facilities Authority (CHEFA) and trustee	661,338	--	--	--	--	--	--	661,338
Construction fund	--	--	--	--	--	--	--	--
Funds held in trust by others	42,218,163	--	--	--	--	--	--	42,218,163
Long-term investments	9,900,286	46,076	55,350	--	--	--	--	10,001,712
Board-designated endowment funds	2,974,503	--	--	--	--	--	--	2,974,503
Other receivables	290,416	--	--	--	--	--	--	290,416
Goodwill	200,500	--	--	--	--	1,613,067	--	1,813,567
CHEFA obligations issue expense, less amortization	321,666	--	--	--	--	--	--	321,666
	55,905,534	46,076	55,350	--	--	1,613,067	--	57,620,027
Property, plant and equipment:								
Land	287,549	--	--	--	--	--	--	287,549
Buildings and improvements	87,936,502	1,150,646	408,435	1,134,076	2,621,721	334,279	--	92,117,304
Equipment	174,931,365	5,945,100	689,803	--	1,917,412	--	--	184,952,035
Construction in progress	2,358,644	--	--	--	--	114,371	--	2,473,015
Accumulated depreciation	(222,405,856)	(4,952,624)	(734,266)	(1,101,825)	(1,391,945)	(108,943)	--	(230,695,459)
	43,108,204	2,143,122	363,972	32,251	3,147,188	339,707	--	49,134,444
Total Assets	\$ 156,554,549	\$ 4,634,628	\$ 5,142,729	\$ 360,191	\$ 6,586,211	\$ 2,899,338	\$ (646,275)	\$ 175,531,371

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET (CONTINUED)

SEPTEMBER 30, 2012

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Liabilities and Net Assets								
Current Liabilities								
Accounts payable and accrued expenses	\$ 26,966,152	\$ 364,278	\$ 543,597	\$ 59,952	\$ 1,098,186	\$ 34,751	\$ (646,275)	\$ 28,420,641
Salaries, wages, payroll taxes and amounts withheld from employees	6,072,850	--	127,190	--	549,742	1,575,392	--	8,325,174
Due to third-party reimbursement agencies	601,271	--	--	--	--	--	--	601,271
Current portion of CHEFA obligations	451,444	--	--	--	--	--	--	451,444
Current portion of notes payable	461,461	--	--	--	204,915	--	--	666,376
Due to affiliates	3,551,101	--	--	--	(25,013)	(526,148)	--	2,999,940
Total Current Liabilities	38,104,279	364,278	670,787	59,952	1,827,830	1,083,995	(646,275)	41,464,846
Other Noncurrent Liabilities								
CHEFA Obligations - less current portion and discount	21,417,424	--	--	--	435,643	--	--	21,853,067
Notes Payable - less current portion	1,105,261	--	--	--	321,030	--	--	1,426,291
Net Assets								
Unrestricted	18,516,310	2,733,024	2,906,762	255,203	4,001,708	1,815,343	--	30,228,350
Temporarily restricted	7,645,420	--	--	--	--	--	--	7,645,420
Permanently restricted	45,010,199	--	--	--	--	--	--	45,010,199
Total Net Assets Excluding Noncontrolling Interests	71,171,929	2,733,024	2,906,762	255,203	4,001,708	1,815,343	--	82,883,969
Noncontrolling Interests								
	--	1,537,326	1,565,180	45,036	--	--	--	3,147,542
Total Net Assets	71,171,929	4,270,350	4,471,942	300,239	4,001,708	1,815,343	--	86,031,511
	\$ 156,554,549	\$ 4,634,628	\$ 5,142,729	\$ 360,191	\$ 6,586,211	\$ 2,899,338	\$ (646,275)	\$ 175,531,371

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2011 (RESTATED)

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc.	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Assets								
Current Assets								
Cash and cash equivalents	\$ 10,101,423	\$ 2,261,550	\$ 1,381,166	\$ 150,640	\$ 1,266,286	\$ 249,604	\$ --	\$ 15,410,669
Short-term investments	--	--	401,931	--	--	--	--	401,931
Patient accounts receivable, net	23,622,121	877,050	1,699,666	134,089	2,888,957	403,439	(594,612)	29,030,710
Grants and other receivables	4,009,154	--	--	--	257,729	154,449	(192,833)	4,228,499
Inventories of supplies	3,109,790	--	--	--	148,972	--	--	3,258,762
Prepaid insurance and other expenses	1,449,521	--	56,694	4,550	115,906	120,487	--	1,747,158
Due from third-party reimbursement agencies	2,858,086	--	--	--	--	--	--	2,858,086
Due from affiliates	5,247,541	--	--	--	(1,771,409)	372,817	--	3,848,949
Total Current Assets	50,397,636	3,138,600	3,539,457	289,279	2,906,441	1,300,796	(787,445)	60,784,764
Funds held in escrow by agreement with the State of Connecticut Health and Educational Facilities Authority (CHEFA) and trustee	3,958,301	--	--	--	--	--	--	3,958,301
Construction fund	--	--	--	--	--	--	--	--
Funds held in trust by others	37,339,264	--	--	--	--	--	--	37,339,264
Long-term investments	8,719,340	41,287	--	--	--	--	--	8,760,627
Board-designated endowment funds	2,615,009	--	--	--	--	--	--	2,615,009
Other receivables	3,240	--	--	--	--	--	--	3,240
Goodwill	200,500	--	--	--	--	1,613,067	--	1,813,567
CHEFA obligations issue expense, less amortization	360,656	--	--	--	--	--	--	360,656
	49,238,009	41,287	--	--	--	1,613,067	--	50,892,363
Property, plant and equipment:								
Land	287,549	--	--	--	--	--	--	287,549
Buildings and improvements	84,975,468	939,114	451,590	--	2,621,721	--	--	88,987,893
Equipment	168,608,541	8,318,347	676,462	1,134,076	1,793,693	329,419	--	180,860,538
Construction in progress	2,883,755	--	--	--	25,000	114,371	--	3,023,126
Accumulated depreciation	(214,304,472)	(6,691,757)	(638,404)	(1,088,107)	(783,562)	(36,147)	--	(223,542,449)
	42,450,841	2,565,704	489,648	45,969	3,656,852	407,643	--	49,616,657
	\$ 146,044,787	\$ 5,745,591	\$ 4,029,105	\$ 335,248	\$ 6,563,293	\$ 3,321,506	\$ (787,445)	\$ 165,252,085

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET (CONTINUED)

SEPTEMBER 30, 2011 (RESTATED)

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc.	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Liabilities and Net Assets								
Current Liabilities								
Accounts payable and accrued expenses	\$ 28,442,732	\$ 350,041	\$ 462,510	\$ 92,375	\$ 460,438	\$ 59,738	\$ (787,445)	\$ 29,080,389
Salaries, wages, payroll taxes and amounts withheld from employees	7,272,613	--	119,751	--	1,258,251	1,446,425	--	10,097,040
Current portion of CHEFA obligations	423,779	--	--	--	--	--	--	423,779
Current portion of notes payable	370,853	--	--	20,318	193,045	--	--	584,216
Total Current Liabilities	<u>36,509,977</u>	<u>350,041</u>	<u>582,261</u>	<u>112,693</u>	<u>1,911,734</u>	<u>1,506,163</u>	<u>(787,445)</u>	<u>40,185,424</u>
Other Noncurrent Liabilities	<u>19,365,945</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>440,672</u>	<u>--</u>	<u>--</u>	<u>19,806,617</u>
CHEFA Obligations - less current portion and discount	<u>25,207,100</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>25,207,100</u>
Notes Payable - less current portion	<u>973,089</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>525,945</u>	<u>--</u>	<u>--</u>	<u>1,499,034</u>
Net Assets								
Unrestricted	17,379,947	3,453,152	2,240,448	189,172	3,684,942	1,815,343	--	28,763,004
Temporarily restricted	6,477,454	--	--	--	--	--	--	6,477,454
Permanently restricted	40,131,275	--	--	--	--	--	--	40,131,275
Total Net Assets Excluding Noncontrolling Interests	<u>63,988,676</u>	<u>3,453,152</u>	<u>2,240,448</u>	<u>189,172</u>	<u>3,684,942</u>	<u>1,815,343</u>	<u>--</u>	<u>75,371,733</u>
Noncontrolling Interests	--	<u>1,942,398</u>	<u>1,206,396</u>	<u>33,383</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>3,182,177</u>
Total Net Assets	<u>63,988,676</u>	<u>5,395,550</u>	<u>3,446,844</u>	<u>222,555</u>	<u>3,684,942</u>	<u>1,815,343</u>	<u>--</u>	<u>78,553,910</u>
	<u>\$ 146,044,787</u>	<u>\$ 5,745,591</u>	<u>\$ 4,029,105</u>	<u>\$ 335,248</u>	<u>\$ 6,563,293</u>	<u>\$ 3,321,506</u>	<u>\$ (787,445)</u>	<u>\$ 165,252,085</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE YEAR ENDED SEPTEMBER 30, 2012

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Unrestricted Revenues								
Net revenues from services to patients	\$ 230,780,700	\$ 4,933,735	\$ 10,281,358	\$ 549,908	\$ 19,513,656	\$ 6,556,710	\$ (3,503,524)	\$ 269,112,543
Other operating revenues	5,053,184	--	1,254	5,197	4,576,608	1,579,205	(5,430,757)	5,784,691
Net assets released from restrictions	5,609,005	--	--	--	--	--	--	5,609,005
	241,442,889	4,933,735	10,282,612	555,105	24,090,264	8,135,915	(8,934,281)	280,506,239
Operating Expenses								
Salaries	88,660,642	689,090	5,549,606	--	20,977,007	8,732,370	--	124,608,715
Employee benefits	29,181,525	86,757	1,187,110	--	3,897,155	1,127,369	--	35,479,916
Supplies and other	94,251,364	2,063,252	2,306,707	463,555	7,330,432	1,167,335	(8,934,281)	98,648,364
Bad debts	10,435,502	(16,456)	164,721	--	135,111	245,650	--	10,964,528
Depreciation	8,028,339	370,254	97,257	13,718	658,328	73,788	--	9,241,684
Interest and amortization	1,101,603	--	--	148	58,782	--	--	1,160,533
	231,658,975	3,192,897	9,305,401	477,421	33,056,815	11,346,512	(8,934,281)	280,103,740
Income (Loss) from Operations	9,783,914	1,740,838	977,211	77,684	(8,966,551)	(3,210,597)	--	402,499
Nonoperating Gains (Losses)								
Unrestricted gifts and bequests	83,577	--	--	--	--	--	--	83,577
Investment income	1,594,603	--	13,005	--	--	--	--	1,607,608
	1,678,180	--	13,005	--	--	--	--	1,691,185
Excess (Deficiency) of Revenues Over Expenses Before Changes in								
Net Unrealized Gains on Investments	11,462,094	1,740,838	990,216	77,684	(8,966,551)	(3,210,597)	--	2,093,684
Changes in Net Unrealized Gains on Investments	357,661	--	34,882	--	--	--	--	392,543
Excess (Deficiency) of Revenues Over Expenses	11,819,755	1,740,838	1,025,098	77,684	(8,966,551)	(3,210,597)	--	2,486,227
Less Excess of Revenue over Expenses Attributable to Noncontrolling Interests	--	--	--	--	--	--	(997,139)	(997,139)
Excess (Deficiency) of Revenues Over Expenses Attributable to Controlling Interest	\$ 11,819,755	\$ 1,740,838	\$ 1,025,098	\$ 77,684	\$ (8,966,551)	\$ (3,210,597)	\$ (997,139)	\$ 1,489,088

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE YEAR ENDED SEPTEMBER 30, 2011 (RESTATED)

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Unrestricted Revenues								
Net revenues from services to patients	\$ 227,759,506	\$ 5,372,114	\$ 9,841,590	\$ 617,265	\$ 20,731,882	\$ 4,009,213	\$ (2,468,710)	\$ 265,862,860
Other operating revenues	2,698,433	3,145	1,536	25,231	4,603,080	944,669	(4,585,463)	3,690,631
Net assets released from restrictions	5,919,545	--	--	--	--	--	--	5,919,545
	236,377,484	5,375,259	9,843,126	642,496	25,334,962	4,953,882	(7,054,173)	275,473,036
Operating Expenses								
Salaries	99,160,311	660,064	5,416,451	--	23,808,078	5,227,616	--	134,272,520
Employee benefits	30,355,478	1,103,377	1,136,223	--	3,122,358	656,685	--	35,381,121
Supplies and other	85,881,091	1,984,823	2,198,699	406,796	6,617,697	817,385	(7,054,173)	90,852,318
Bad debts	13,122,386	(28,740)	132,860	--	435,004	206,657	--	13,868,167
Depreciation	7,993,796	442,510	103,212	129,283	607,768	36,744	--	9,313,313
Operations improvement	285,998	--	--	--	--	--	--	285,998
Interest and amortization	1,113,937	--	--	12,949	75,517	--	--	1,202,403
	237,912,997	3,169,034	8,987,445	549,028	34,666,422	6,945,087	(7,054,173)	285,175,840
Income (Loss) from Operations	(1,535,513)	2,206,225	855,681	93,468	(9,331,460)	(1,991,205)	--	(9,702,804)
Nonoperating Gains (Losses)								
Unreimbursed start-up costs	(202,579)	--	--	--	--	--	--	(202,579)
Unrestricted gifts and bequests	276,737	--	--	--	--	--	--	276,737
Investment in come	1,670,892	--	11,162	--	--	--	--	1,682,054
Loss on extinguishment of debt	(1,082,212)	--	--	--	--	--	--	(1,082,212)
	662,838	--	11,162	--	--	--	--	674,000
Excess (Deficiency) of Revenues Over Expenses Before Changes in Net Unrealized Losses on Investments	(872,675)	2,206,225	866,843	93,468	(9,331,460)	(1,991,205)	--	(9,028,804)
Changes in Net Unrealized Losses on Investments	(528,630)	--	(1,108)	--	--	--	--	(529,738)
Excess (Deficiency) of Revenues Over Expenses	(1,401,305)	2,206,225	865,735	93,468	(9,331,460)	(1,991,205)	--	(9,558,542)
Less Excess of Revenue over Expenses Attributable to Noncontrolling Interests	--	--	--	--	--	--	(1,111,268)	(1,111,268)
Excess (Deficiency) of Revenues Over Expenses Attributable to Controlling Interest	(1,401,305)	2,206,225	865,735	93,468	(9,331,460)	(1,991,205)	(1,111,268)	(10,669,810)