



CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Bridgeport Hospital & Healthcare Services, Inc.
and Subsidiaries
Years Ended September 30, 2013 and 2012
with Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Consolidated Financial Statements
and Supplementary Information

Years Ended September 30, 2013 and 2012

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Report of Independent Auditors

The Board of Directors
Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

We have audited the accompanying consolidated financial statements of Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries (“BHHS”), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related consolidated notes to the financial statements.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Bridgeport Hospital & Healthcare Services, Inc. at September 30, 2013 and 2012, and the consolidated results of its operations and changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Change in Presentation of the Provision for Bad Debts

As discussed in Note 1 to the accompanying consolidated financial statements, in 2013, BHHS adopted the provisions of Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, which resulted in a change to the presentation of the provision for bad debts in the accompanying consolidated statements of operations and changes in net assets effective October 1, 2011. Our opinion is not modified with respect to this matter.

Ernst + Young LLP

December 23, 2013

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Consolidated Balance Sheets

	September 30	
	2013	2012
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 30,636	\$ 16,072
Short term investments	64,307	69,590
Accounts receivable for services to patients, less allowances for uncollectible accounts, charity and free care of approximately \$29,300 in 2013, and \$19,025 in 2012	51,432	42,983
Professional liabilities insurance recoveries receivable – current portion	10,552	11,424
Other current assets	17,755	16,703
Assets limited as to use	–	1,875
Total current assets	<u>174,682</u>	<u>158,647</u>
Long-term investments	53,099	47,464
Professional liabilities insurance recoveries receivable – non-current	22,167	31,106
Other assets	31,885	22,600
Goodwill	17,217	3,701
Property, plant, and equipment:		
Land, buildings, and improvements	124,308	126,716
Equipment	285,812	269,265
	<u>410,120</u>	<u>395,981</u>
Less accumulated depreciation	285,773	284,026
	<u>124,347</u>	<u>111,955</u>
Construction in progress	19,477	17,163
	<u>143,824</u>	<u>129,118</u>
Total assets	<u>\$ 442,874</u>	<u>\$ 392,636</u>

	September 30	
	2013	2012
	<i>(In Thousands)</i>	
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 16,363	\$ 10,208
Accrued expenses	47,877	47,324
Current portion of long-term debt	32,205	3,809
Professional liabilities – current portion	10,552	11,424
Other current liabilities	5,306	6,775
Total current liabilities	<u>112,303</u>	<u>79,540</u>
Long-term debt, net of current portion	49,202	47,436
Accrued pension obligation	42,945	67,041
Professional liabilities	34,291	43,247
Other long-term liabilities	31,022	34,640
Total liabilities	<u>269,763</u>	<u>271,904</u>
Commitments and contingencies		
Net assets:		
Unrestricted	120,290	72,028
Temporarily restricted	32,033	28,832
Permanently restricted	20,788	19,872
Total net assets	<u>173,111</u>	<u>120,732</u>
Total liabilities and net assets	<u>\$ 442,874</u>	<u>\$ 392,636</u>

See accompanying notes.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended September 30	
	2013	2012
	<i>(In Thousands)</i>	
Operating revenue:		
Net Patient service revenue	\$ 433,811	\$ 420,616
Less: Provision for bad debts	(14,984)	(16,623)
Net patient service revenue, less provision for bad debts	418,827	403,993
Other revenue	26,208	19,050
Total operating revenue	445,035	423,043
Operating expenses:		
Salaries and benefits	195,993	191,568
Supplies and other expenses	204,231	186,260
Depreciation and amortization	22,858	20,233
Insurance	1,028	2,890
Interest	1,665	2,724
Total operating expenses	425,775	403,675
Income from operations	19,260	19,368
Non-operating gains and losses, net	3,969	2,164
Excess of revenue over expenses	23,229	21,532

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

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

	Year Ended September 30	
	2013	2012
	<i>(In Thousands)</i>	
Unrestricted net assets:		
Excess of revenue over expenses	\$ 23,229	\$ 21,532
Net assets released from restrictions used for capital acquisitions	879	1,641
Transfers from Yale-New Haven Health Services Corporation	900	900
Other transfers	444	(5)
Pension liability adjustment	22,810	(24,104)
Increase (decrease) in unrestricted net assets	<u>48,262</u>	<u>(36)</u>
Temporarily restricted net assets:		
Net assets released from restrictions used for operations	(6,346)	(4,975)
Net assets released from restrictions used for capital acquisitions	(879)	(1,641)
Change in unrealized gains and losses on investments	2,330	1,932
Bequests, contributions, and grants	6,138	6,536
Net realized investment gains	1,042	1,599
Other changes in net assets	916	384
Increase in temporarily restricted net assets	<u>3,201</u>	<u>3,835</u>
Permanently restricted net assets:		
Bequests, contributions, and grants	916	791
Increase in permanently restricted net assets	<u>916</u>	<u>791</u>
Increase in net assets	<u>52,379</u>	<u>4,590</u>
Net assets at beginning of year	<u>120,732</u>	<u>116,142</u>
Net assets at end of year	<u>\$ 173,111</u>	<u>\$ 120,732</u>

See accompanying notes.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended September 30	
	2013	2012
	<i>(In Thousands)</i>	
Cash flows from operating activities		
Increase in net assets	\$ 52,379	\$ 4,590
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	22,858	20,233
Bad debts	14,984	16,623
Change in unrealized gains and losses on investments	(5,882)	(3,538)
Bequests and contributions	(7,054)	(7,327)
Loss on refunding and refinancing of long-term debt	-	1,799
Pension liability adjustment	(22,810)	24,104
Changes in operating assets and liabilities:		
Accounts receivable, net	(23,433)	(17,787)
Other assets	(10,337)	(16,792)
Accounts payable	6,155	(3,100)
Accrued expenses	553	7,156
Professional insurance recoverable and liabilities	(17)	(1,110)
Other current liabilities, accrued pension obligation, and other long-term liabilities	(6,373)	(10,429)
Net cash provided by operating activities	<u>21,023</u>	<u>14,422</u>
Cash flows from investing activities		
Net change in investments	5,530	(26,577)
Assets limited as to use	1,875	8,632
Cash paid for acquisition, net of cash acquired	(13,516)	-
Acquisitions of property, plant and equipment, net	(37,564)	(22,839)
Net cash used in investing activities	<u>(43,675)</u>	<u>(40,784)</u>
Cash flows from financing activities		
Proceeds from line of credit	25,000	-
Proceeds from note payable	14,000	-
Proceeds from issuance of debt	-	40,468
Proceeds from issuance of term loan	-	5,500
Refunding of long-term debt	-	(47,145)
Cost of issuance of long-term debt	-	(780)
Repayments of long-term debt	(4,313)	(385)
Repayments of note payable	(4,525)	-
Bequests and contributions	7,054	7,327
Net cash provided by financing activities	<u>37,216</u>	<u>4,985</u>
Net increase (decrease) in cash and cash equivalents	<u>14,564</u>	<u>(21,377)</u>
Cash and cash equivalents at beginning of year	16,072	37,449
Cash and cash equivalents at end of year	<u>\$ 30,636</u>	<u>\$ 16,072</u>

See accompanying notes.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2013

1. Organization and Significant Accounting Policies

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries (BHHS) is a Connecticut not-for-profit, nonstock corporation established to promote and carry out charitable, scientific, and educational activities. BHHS is the sole member of the following not-for-profit, nonstock corporations: Bridgeport Hospital (the Hospital), Bridgeport Hospital Foundation, Inc. (the Foundation), Southern Connecticut Health System Properties, Inc. (Properties), and the Parent.

BHHS currently conducts no significant business activities and has no employees. Yale-New Haven Health Services Corporation (YNHHSC) is the sole member of BHHS and two similar organizations. Each of these three tax-exempt organizations serves as the sole member/parent for its respective delivery network of regional health care providers and related entities. Under the terms of an agreement with YNHHSC, BHHS continues to operate autonomously with separate boards, management and medical staff; however, YNHHSC approves the strategic plans, operating and capital budgets, and board appointments.

The Hospital, the largest entity among BHHS's subsidiaries, provides health care services to the Fairfield County community. The Foundation solicits contributions for the benefit of BHHS, and all other tax-exempt healthcare organizations associated with BHHS. Properties is a real estate holding company

The accounting policies that affect significant elements of BHHS's consolidated financial statements are summarized below.

Principles of Consolidation

The accompanying consolidated financial statements present BHHS and its subsidiaries. In consolidating the financial statements of the parent company and its subsidiaries, all significant intercompany revenues and expenses and intercompany balance sheet amounts have been eliminated in consolidation.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, including estimated uncollectibles for accounts receivable for services to patients, and liabilities, including estimated receivables and payables to third-party payors, and professional liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the amounts of revenue and expenses during the reporting 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.

During fiscal 2013 the Hospital recorded a change in estimate of approximately \$6.4 million related to favorable third-party settlements and during fiscal 2012 recorded a change in estimate of approximately \$4.1 million related to favorable third-party settlements.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those assets whose use by BHHS has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by BHHS in perpetuity. See Notes 5 and 6 for additional information relative to temporarily and permanently restricted net assets.

Donor Restricted Gifts

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

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Pledges receivable, included in other current assets and other assets in the accompanying consolidated balance sheets at September 30, 2013 and 2012, are expected to be received as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Due in one year or less	\$ 591	\$ 1,761
Due after one year through five years	214	400
Total pledges receivable	<u>805</u>	<u>2,161</u>
Less allowance for doubtful pledges	<u>(24)</u>	<u>(43)</u>
Pledges receivable, net	<u>\$ 781</u>	<u>\$ 2,118</u>

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid financial instruments with original maturities of three months or less when purchased, which are not classified as assets limited as to use or held in the long-term investment portfolio.

Cash and cash equivalents are maintained with domestic financial institutions with deposits, which exceed federally insured limits. It is BHHS's policy to monitor the financial strength of these institutions.

Accounts Receivable

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

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

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Investments

BHHS has designated all investments reported in the accompanying consolidated balance sheets as trading securities. As such, unrealized gains and losses are included in the excess of revenue over expenses.

Investments in marketable equity securities with readily determinable fair market values and all investment in debt securities (marketable investments) are measured at fair value based on quoted market prices.

BHHS participates in the Yale New Haven Health System Investment Trust (the Trust), a unitized Delaware Investment Trust created to pool assets for investment by the Health System non-profit entities. The Trust is comprised of two pools: the Long-Term Investment Pool (L-TIP) and the Intermediate-Term Investment Pool (I-TIP). Governance of the Trust is performed by the Yale New Haven Health System Investment Committee.

Under the terms of the investment management agreement with the Trust, withdrawals of the Hospital's investment in the L-TIP can be made annually by the Hospital on July 1. Amounts withdrawn are subject to a schedule that allows larger withdrawals with longer notice periods. As of September 30, 2013, the Hospital can withdraw 100% of its investment in the L-TIP on July 1, 2012. Withdrawals of the Hospital's investment in the I-TIP in any amount can be made quarterly with 30 days advance notice.

Certain alternative investments (non-traditional, not-readily-marketable assets) are structured such that BHHS holds limited partnership interests or pooled units and are accounted for under the equity method and utilizing Yale University's (the University) reported net asset value per unit for measurement of the units' fair value for the Yale University investment.

Individual investment holdings within the alternative investments may, in turn, include investments in both non-marketable and market-traded securities. Valuations of those investments and, therefore, BHHS's holdings may be determined by the investment manager or general partner. Fund of funds investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. The equity method reflects net contributions to the investee and an ownership share of realized and unrealized investment income and expenses.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

The investments may indirectly expose BHHS to securities lending, short sales of securities, and trading in futures and forwards contracts, options, swap contracts and other derivative products. While these financial instruments may contain varying degrees of risk, BHHS's risk with respect to such transactions is limited to its capital balance in each investment. The financial statements of the investees are audited annually by independent auditors.

The Trust has an agreement with the University's investment office (the Investment Management Agreement) which allows the University to manage a portion of the Trust's investments as part of the University's Endowment Pool (the Pool). Under the terms of the agreement for the year ended September 30, 2012, the Trust transferred \$50.0 million to the University in exchange for units in the Pool. The Trust's interest in the Pool is reported at fair value based on the net asset value per units held. The Pool invests in domestic equity, foreign equity, absolute return, private equity, real estate, fixed income, and cash.

Under the terms of the investment management agreement with the University, withdrawals of the Trust's investment in the Pool can be made annually by the Trust on July 1. For withdrawals of amounts less than \$150.0 million or 75% of the Trust's investment in the Pool, \$100.0 million or 50% of the Trust's investment in the Pool, and \$50.0 million or 25% of the Trust's investment in the Pool, the advance notice period is set to a maximum of 180 days, 90 days, and 30 days, respectively, prior to the University's fiscal year ending June 30. For withdrawals greater than \$150.0 million or more than 75% of the Trust's investment in the Pool, the advance notice period is set to a maximum of 270 days prior to the University's fiscal year end of June 30.

In 2011 the Investment Management Agreement between the Trust and the University was modified to allow the Trust to obtain a cash advance, up to a maximum of \$75 million, on a monthly basis. For these advances, an interest charge of Prime plus two percent (2%) will be paid by the Trust. Repayments on the advances are made by the Trust by way of redemptions of a sufficient number of the Trust's units in the Endowment using the June 30th unit valuation. No advances have been requested or taken by the Trust.

Net realized gains and losses on investments, and interest and dividends are included in excess of revenue over expenses unless the income or loss is restricted by donor or law. The change in unrealized gains and losses on all investments is included in the excess of revenue over expenses unless the income or loss is restricted by the donor.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use include assets held by trustee under bond indenture agreements. Amounts required to meet current liabilities are reported as current assets. These funds primarily consist of equities, corporate obligations, U.S. Government obligations, mutual funds, marketable securities, and money market funds. Changes in unrealized gains and losses are recorded in the excess of revenue over expenses and losses.

Inventories

Inventories, included in prepaid expenses and other current assets, are stated at the lower of cost or market. BHHS values its inventories using the first-in, first-out method.

Deferred Financing Costs

Deferred financing costs represent costs incurred to obtain long-term financing. Amortization of the costs is provided using a method that approximates the interest method over the remaining term of the applicable indebtedness. The accumulated amortization of deferred financing costs was approximately \$0.1 million at September 30, 2013 and 2012. See Note 7 for additional information relative to debt-related matters.

Benefits and Insurance

The Hospital provides medical, dental, hospitalization and prescription drug benefits to employees for which it is self-insured. Liabilities have been accrued for claims, including claims incurred but not reported (IBNRs), which are based on specific experience. At September 30, 2013 and 2012, the estimated liability for self-insured employee medical, prescriptions and other benefit claims and IBNRs aggregated approximately \$0.9 million and \$1.0 million, respectively, and is included in accrued expenses in the accompanying consolidated balance sheets.

The Hospital is effectively self-insured for workers' compensation claims. Estimated amounts are accrued for claims, including IBNRs, which are based on specific experience. At September 30, 2013 and 2012, the estimated liability for self-insured workers' compensation claims and IBNRs aggregated approximately \$5.6 million and \$5.2 million, respectively, discounted at 2.5% in 2013 and 3.0% in 2012, and is included in other long-term liabilities in the accompanying consolidated balance sheets.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Property, Plant, and Equipment

Property, plant, and equipment purchased are carried at cost and those acquired by gifts and bequests are carried at fair value established at the date of contribution. The carrying amounts of assets and the related accumulated depreciation and amortization are removed from the accounts when such assets are disposed of and any resulting gain or loss is included in operations. Depreciation of property, plant, and equipment is computed by the straight-line method in amounts sufficient to depreciate the cost of the assets over their estimated useful lives ranging from 3 to 50 years.

Goodwill

During 2013, the Hospital acquired substantially all of the business, assets, and operations of Robert D. Russo and Associates Radiology P.C. (“Russo Radiology”). The acquisition includes installment payments totaling \$15 million, including interest, ranging from approximately \$1.5 million to \$3.9 million due from May 2013 through June 2017. At September 30, 2013, the Hospital has a liability of approximately \$9.5 million remaining. BHHS has accounted for the business combination by applying the acquisition method of accounting in accordance with Accounting Standards Codification Topic 805, *Business Combinations*. The purchase price in excess of the fair value of identified assets aggregated approximately \$13.5 million which has been recorded as goodwill. There were no liabilities assumed at the acquisition date.

In 2011, the Hospital acquired certain tangible and intangible assets of Cardiac Specialists, P.C. for \$1.6 million. As a result of the transaction, goodwill in the amount of approximately \$0.8 million was recorded and is included in other assets at September 30, 2013 and 2012.

The Hospital is required to perform an annual review of its goodwill for impairment. Based on the Hospital’s review at September 30, 2013 and 2012, goodwill was determined not to be impaired.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Excess of Revenue over Expenses

In the accompanying statements of operations and changes in net assets, excess of revenue over expenses is the performance indicator. Peripheral or incidental transactions are included in excess of revenue over expenses. Those gains and losses deemed by management to be closely related to ongoing operations are included in other revenue; other gains and losses are classified as non operating gains and losses.

Contributions of, or restricted to, property, plant, and equipment, transfers of assets to and from affiliates for other than goods and services, and pension and other post-retirement liability adjustments are excluded from the performance indicator but are included in the changes in net assets.

Income Taxes

BHHS, the Hospital and the Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal and state income taxes on related income pursuant to Section 501(a) of the Code. Properties is a tax-exempt organization pursuant to Section 501(c)(2) of the Code and also is not subject to federal and state income taxes.

Asset Retirement Obligation

The Hospital maintains an asset retirement obligation liability related to the estimated future costs to remediate environmental liabilities in certain buildings. The asset and asset retirement obligation liability were approximately \$0.4 million and \$12.1 million, respectively, at September 30, 2013 and approximately \$0.4 million and \$12.8 million, respectively, at September 30, 2012.

Reclassifications

Certain reclassifications have been made to the year ended September 30, 2012 balances previously reported in the financial statements in order to conform with the year ended September 30, 2013 presentation, including the reclassification of provision for doubtful accounts on the statements of operations related to the adoption of ASU 2011-07.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Change in Accounting Principle

In July 2011, the Financial Accounting Standards Board issued Accounting Standards Update (“ASU”) No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (“ASU No. 2011-07”). In accordance with ASU No. 2011-07, BHHS changed the presentation of its consolidated statement of operations and changes in net assets by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue, similar to contractual allowances and discounts. Additionally, BHHS has provided enhanced disclosures about its policies for recognizing revenue and assessing bad debts, as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. BHHS adopted this accounting standard update as of October 1, 2012, and retrospectively applied the presentation of the provision for bad debts in the accompanying consolidated statements of operations and changes in net assets to all periods presented. The enhanced disclosure requirements are required in the period of adoption and subsequent reporting periods (see Note 2). BHHS’s adoption of this update has no effect on the previously reported excess of revenue over expenses or on net assets.

2. Net Patient Service Revenue and Accounts Receivable for Services to Patients

The Hospital has agreements with third party payors that provide for payments to the Hospital at amounts different from its established rates. The difference is accounted for as allowances. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, fee-for-service, discounted charges and per diem payments. Net patient service revenue is affected by the Connecticut Disproportionate Share Hospital Program, includes premium revenue and is reported at the estimated net realizable amounts due from patients, third-party payors and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations.

Third-party payor receivables included in other receivables were \$2.7 million and \$5.3 million at September 30, 2013 and 2012, respectively. Third-party payor receivables included in other long-term assets were \$3.4 million and \$2.8 million at September 30, 2013 and 2012, respectively. Third-party payor liabilities included in other current liabilities were \$4.5 million

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Net Patient Service Revenue and Accounts Receivable for Services to Patients (continued)

and \$6.1 million at September 30, 2013 and 2012, respectively. Third-party payor liabilities included in other long-term liabilities were \$13.4 million and \$14.9 million at September 30, 2013 and 2012, respectively.

The Hospital has established estimates based on information presently available, of amounts due to or from Medicare, Medicaid and third-party payors for adjustments to current and prior year payment rates, based on industry-wide and Hospital-specific data. Such amounts are included in the accompanying balance sheets. Additionally, certain payors' payment rates for various years have been appealed by the Hospital. If the appeals are successful, additional income applicable to those years might be realized.

Revenue from Medicare and Medicaid programs accounted for approximately 38% and 18%, respectively, of the Hospital's net patient service revenue for the year ended September 30, 2013 and 36% and 18% for the year ended September 30, 2012. Inpatient discharges relating to Medicare and Medicaid programs accounted for approximately 39% and 31%, respectively, for the year ended September 30, 2013 and approximately 39% and 32%, respectively, for the year ended September 30, 2012. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and are subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. 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. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital. Cost reports for the Hospital, which serve as the basis for final settlement with government payors, have been settled by final settlement through 2007 for Medicare and 1994 for Medicaid. Other years remain open for settlement.

The significant concentrations of accounts receivable for services to patients include 21% from Medicare, 13% from Medicaid, and 66% from non-governmental payors at September 30, 2013 and 2012.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Net Patient Service Revenue and Accounts Receivable for Services to Patients
(continued)**

Net patient service revenue is comprised of the following for the years ended September 30, 2013 and 2012 (in thousands):

	<u>2013</u>	<u>2012</u>
Gross revenue from patients	\$ 1,512,520	\$ 1,390,798
Deductions:		
Contractual allowances	1,041,542	942,001
Charity and free care (at charges)	37,167	28,181
Provision for doubtful accounts	14,984	16,623
Net patient service revenue	<u>\$ 418,827</u>	<u>\$ 403,993</u>

Patient service revenue for the year ended September 30, 2013, net of contractual allowances and discounts (but before the provision for bad debts), recognized from these major payor sources based on primary insurance designation is, in thousands, as follows:

	<u>Third-Party</u>	<u>Self-Pay</u>	<u>Total All Payors</u>
Patient service revenue (net of contractual allowances and discounts)	\$418,510	\$15,301	\$433,811

Deductibles and copayments under third-party payment programs within the third-party payor amount above are the patient's responsibility and the Hospital considers these amounts in its determination of the provision for bad debts based on collection experience. Accounts receivable are also reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Net Patient Service Revenue and Accounts Receivable for Services to Patients (continued)

The Hospital's allowance for doubtful accounts totaled approximately \$29.3 million and \$19.0 million at September 30, 2013 and 2012, respectively. The allowance for doubtful accounts for self-pay patients was approximately 78.5% and 77.0% of self-pay accounts receivable as of September 30, 2013 and 2012, respectively. Overall, the total of self-pay discounts and write-offs did not change significantly in 2013. The Hospital did not experience significant changes in write-off trends and did not change its charity care policy in 2013.

3. Uncompensated Care and Community Benefit Expense

BHHS's commitment to community service is evidenced by services provided to the poor and benefits provided to the broader community. Services provided to the poor include services provided to persons who cannot afford healthcare because of inadequate resources and/or who are uninsured or underinsured.

BHHS makes available free care programs for qualifying patients. In accordance with the established policies of BHHS, during the registration, billing and collection process a patient's eligibility for free care funds is determined. For patients who were determined by BHHS to have the ability to pay but did not, the uncollected amounts are bad debt expense. For patients who do not avail themselves of any free care program and whose ability to pay cannot be determined by BHHS, care given but not paid for, is classified as charity care.

Together, charity care and bad debt expense represent uncompensated care. The estimated cost of total uncompensated care is approximately \$22.3 million and \$17.7 million for the years ended September 30, 2013 and 2012, respectively. The estimated cost of uncompensated care is based on the ratio of cost to charges, as determined by claims activity. The allocation between bad debt and charity care is determined based on management's analysis on the previous 12 months of hospital data. The estimated cost of charity care is estimated using the ratio of cost to gross charges applied to the gross uncompensated cost associated with providing charity care.

The estimated cost of charity care provided was \$16.4 million and \$11.2 million for the years ended September 30, 2013 and 2012, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Uncompensated Care and Community Benefit Expense (continued)

For the years ended September 30, 2013 and 2012, bad debt expense, at charges, was \$15.0 million and \$16.6 million, respectively. For the years ended September 30, 2013 and 2012, bad debt expense, at cost, was \$5.9 million and \$6.6 million, respectively. The bad debt expense is multiplied by the ratio of cost to charges for purposes of inclusion in the total uncompensated care amount identified above.

The Connecticut Disproportionate Share Hospital Program (CDSHP) was established to provide funds to hospitals for the provision of uncompensated care and is funded, in part, by a 1% assessment on hospital net inpatient service revenue. During the years ended September 30, 2013 and 2012, the Hospital received \$17.7 million and \$20.0 million, respectively, in distributions from CDSHP, of which approximately \$12.6 million was related to charity care. The Hospital made payments into CDSHP of \$16.9 million and \$16.9 million for the years ended September 30, 2013 and 2012, respectively, for the 1% assessment.

Additionally, BHHS provides benefits for the broader community which includes services provided to other needy populations that may not qualify as poor but need special services and support. Benefits include the cost of health promotion and education of the general community, interns and residents, health screenings, and medical research. The benefits are provided through the community health centers, some of which service non-English speaking residents, disabled children, and various community support groups. BHHS voluntarily assists with the direct funding of several City of Bridgeport programs, including an economic development program and a youth initiative program.

In addition to the quantifiable services defined above, BHHS provides additional benefits to the community through its advocacy of community service by employees. BHHS's employees serve numerous organizations through board representation, membership in associations and other related activities. BHHS also solicits the assistance of other healthcare professionals to provide their services at no charge through participation in various community seminars and training programs.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments and Assets Limited as to Use

The composition of investments, including investments held by the Trust, amounts on deposit with trustee in debt service fund and assets limited as to use is set forth in the following table (in thousands):

	2013	2012
Money market funds	\$ 7,737	\$ 7,930
Mutual Funds	–	145
U.S. equity securities	7,004	5,840
U.S. equity securities – common collective trusts	1,514	819
International equity securities ^(a)	7,224	5,304
Fixed income:		
U.S. government	18,018	23,353
U.S. government – common collective trusts	7,509	11,502
Corporate debt	3,733	2,362
International government ^(b)	6,536	5,945
Commodities	173	111
Hedge funds:		
Absolute return ^(c)	–	5,169
Long/short equity ^(d)	57	1,732
Real estate ^(e)	1,713	1,957
Interest in Yale University endowment pool ^(f)	56,188	46,760
Total	\$ 117,406	\$ 118,929

(a) Investments with external international equity and bond managers that are domiciled in the United States. Investment managers may invest in American or Global Depository Receipts (ADR, GDR) or in direct foreign securities.

(b) Investments with external commodities futures manager.

(c) Investment with external multi-strategy fund of funds manager investing in publicly traded equity and credit holdings which may be long or short positions.

(d) Investment with an external long-short equity fund of funds manager with underlying portfolio investments consisting of publicly traded equity positions.

(e) Investments with external direct real estate managers and fund of funds managers. Investment vehicles both closed end REITs and limited partnerships.

(f) Yale University Endowment Pool maintains a diversified investment portfolio, through the use of external investment managers operating in a variety of investment vehicles, including separate accounts, limited partnerships and commingled funds. The pool combines a strong orientation to equity investments with a strong allocation to non-traditional asset classes such as an absolute return, private equity, and real assets.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments and Assets Limited as to Use (continued)

BHHS ownership percentage of the Trust was approximately 9.2% and 11.4% as of September 30, 2013 and 2012, respectively. BHHS's prorata portion of the Trust's investments are included in the above table.

BHHS has a 47.6% equity interest in Century Financial Services, Inc. (Century). At September 30, 2013 and 2012, the investment is included in other assets in the accompanying consolidated balance sheets. The investment in Century is carried on the equity basis of accounting and is adjusted for BHHS's proportionate share of undistributed earnings or losses. Dividends received are deducted from the carrying value of the investment.

5. Endowment

The Hospital's endowment includes donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Hospital has interpreted the Connecticut Uniform Prudent Management of Institutional Funds Act (CUPMIFA) 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 direction of the applicable donor gift instrument at the time of the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard of prudence prescribed by CUPMIFA. In accordance with CUPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the Hospital and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the Hospital; and (7) the investment and spending policies of the Hospital.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Endowment (continued)

Changes in endowment net assets for the fiscal year ended September 30, 2013, are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 104	\$ 17,630	\$ 19,872	\$ 37,606
Investment returns:				
Investment income	–	858	–	858
Net appreciation (realized and unrealized)	–	1,239	–	1,239
Total investment return	–	2,097	–	2,097
Appropriation of endowment assets for expenditure	(104)	(1,243)	–	(1,347)
Other changes:				
Contribution bequests	–	2,588	916	3,504
Endowment net assets, end of year	<u>\$ –</u>	<u>\$ 21,072</u>	<u>\$ 20,788</u>	<u>\$ 41,860</u>

Changes in endowment net assets for the fiscal year ended September 30, 2012, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 87	\$ 15,274	\$ 19,081	\$ 34,442
Investment returns:				
Investment income	8	1,131	–	1,139
Net appreciation (realized and unrealized)	9	1,246	–	1,255
Total investment return	17	2,377	–	2,394
Appropriation of endowment assets for expenditure	–	(104)	–	(104)
Other changes:				
Contribution bequests	–	83	791	874
Endowment net assets, end of year	<u>\$ 104</u>	<u>\$ 17,630</u>	<u>\$ 19,872</u>	<u>\$ 37,606</u>

From time to time, the fair value of assets associated with permanently restricted endowment funds may fall below the level determined under Connecticut UPMIFA.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets as of September 30 are available for the following purposes:

	2013	2012
	<i>(In Thousands)</i>	
Indigent care	\$ 19,373	\$ 17,945
Other health care services	12,660	10,887
	\$ 32,033	\$ 28,832

Permanently restricted net assets of approximately \$20.8 million and \$19.9 million for the years ended September 30, 2013 and 2012, respectively, consists of donor-restricted endowment principal. The income generated from permanently restricted funds is expendable for purposes designated by donors, including the support of various health care services.

7. Debt

A summary of debt at September 30 is as follows:

	2013	2012
	<i>(In Thousands)</i>	
Tax-exempt revenue bonds:		
Series D (fixed interest rates ranging from 2.00% to 5.00%)	\$ 34,350	\$ 36,415
Line of credit (1.71% interest rate)	25,000	—
2010 term loan (3.22% fixed interest rate)	4,940	5,543
2012 term loan (1.66% fixed interest rate)	4,167	5,235
Note payable (6.90% fixed interest rate)	9,463	—
Capital lease obligation	95	168
	78,015	47,361
Add: premium	3,392	3,884
Less: current portion	(32,205)	(3,809)
	\$ 49,202	\$ 47,436

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Debt (continued)

In November 2010, the Hospital obtained a \$6.6 million term loan from the State of Connecticut Health and Educational Facilities Authority (CHEFA). The proceeds of the loan are to be used for the purchase and installation of energy savings equipment and various renovations and improvements to the Hospital's infrastructure. The loan is to be paid in monthly installments over 10 years at a fixed interest rate of 3.22%.

In May 2012, the Hospital's Series D tax-exempt revenue bonds were issued through CHEFA under a Master Trust Indenture for approximately \$36.4 million, with coupons ranging from 2.0% to 5.0%, and a final maturity of July 2025. The proceeds, including a premium of approximately \$4.1 million, were held in an escrow account and used for the retirement of the outstanding Series A and C tax-exempt revenue bonds and to pay for certain bond issuance costs of approximately \$0.8 million. The bond premium is being amortized using the effective interest method and is included in interest expense in the accompanying statement of operations and changes in net assets. In connection with the refunding and refinancing, the Hospital recognized a loss in 2012 of approximately \$1.8 million principally related to the write-off of deferred financing costs.

In June 2012, the Hospital obtained a \$5.5 million term loan from CHEFA. The loan is to be paid in monthly installments over five years at a fixed rate of 1.66% with the proceeds to be used for medical and cafeteria equipment. The loan is secured by the equipment purchased with the proceeds of the loan.

In December 2012, in connection with the purchase of Russo Radiology, the Hospital entered into a note payable with the seller in the amount of \$14 million. The note is to be repaid in monthly installments over five years as discussed in Note 1.

In September 2013, the Hospital entered into and drew in full its \$25 million line of credit with a bank. The bank line of credit requires payment of the outstanding principal amount twelve months subsequent to the initial advance. The obligation bears interest at a rate equal to one month LIBOR plus 1.50% per annum.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Debt (continued)

Scheduled principal payments on all debt are as follows (in thousands):

	Debt	Capital Lease Obligations
2014	\$ 32,162	\$ 47
2015	8,227	47
2016	4,657	8
2017	5,646	–
2018	3,323	–
Thereafter	23,905	–
	\$ 77,920	102
Less: interest		(7)
Total capital lease obligation		\$ 95

Cash paid for interest for the years ended September 30, 2013 and 2012, approximated \$1.7 million and \$2.7 million, respectively.

In connection with the Series D bonds, BHHS is required to maintain certain financial covenants. At September 30, 2013 and 2012, BHHS was in compliance with its financial debt covenants.

Assets recorded under the capital lease obligations totaled \$0.3 million and \$0.2 million as of September 30, 2013 and 2012, respectively. Accumulated depreciation for the capital lease obligations totaled \$0.3 million and \$0.1 million for September 30, 2013 and 2012, respectively.

8. Retirement Benefit Plans

The Hospital and certain other affiliates of BHHS have a defined benefit pension plan covering substantially all employees. The benefits are based on years of service and employees' average compensation as defined by the plan documents. The Hospital and affiliates of BHHS make contributions in amounts sufficient to meet the required benefits to be paid to plan participants as they become due as required under the Employee Retirement Income Security Act of 1974.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Retirement Benefit Plans (continued)

On June 30, 2006, the Hospital and certain other affiliates of BHHS froze their defined benefit plan. On October 1, 2006, the Hospital and certain other affiliates of BHHS instituted a defined contribution plan covering substantially all employees. The Hospital matches employee 403(b) contributions on a bi-weekly basis, as defined by the defined contribution plan documents, and provides an annual contribution to the employees' accounts based on each employee's year of service and compensation. The Hospital expensed approximately \$9.5 million and \$9.6 million relating to the defined contribution plan for the years ended September 30, 2013 and 2012, respectively. Amounts due to the defined contribution plan amounted to \$5.2 million and \$4.8 million at September 30, 2013 and 2012, respectively, and are included in accrued expenses in the accompanying balance sheets.

The Hospital is required to measure plan assets and benefit obligations at a date consistent with its fiscal year-end balance sheet. Included in unrestricted net assets at September 30, 2013 and 2012, are the following amounts that have not yet been recognized in net periodic benefit cost (in thousands):

	<u>2013</u>	<u>2012</u>
Unrecognized actuarial loss	\$ (80,198)	\$ (103,008)

The actuarial loss included in unrestricted net assets at September 30, 2013 is \$2.7 million and is expected to be recognized in net periodic benefit cost during the year ending September 30, 2014.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Retirement Benefit Plans (continued)

The following table sets forth the funded status of the Hospital and affiliates of BHHS's plans as of September 30:

	Pension Benefits	
	2013	2012
	<i>(In Thousands)</i>	
Change in benefit obligation		
Benefit obligation, beginning of year	\$ (199,526)	\$ (166,112)
Interest cost	(7,841)	(8,464)
Actuarial gain (loss)	21,397	(30,864)
Benefits paid	6,365	5,914
Benefit obligation, end of year	<u>\$ (179,605)</u>	<u>\$ (199,526)</u>
Change in plan assets		
Fair value of plan assets, beginning of year	\$ 132,485	\$ 107,905
Actual return on plan assets	8,020	14,665
Employer contribution	2,520	15,829
Benefits paid	(6,365)	(5,914)
Fair value of plan assets, end of year	<u>\$ 136,660</u>	<u>\$ 132,485</u>
Accrued pension obligation	<u>\$ (42,945)</u>	<u>\$ (67,041)</u>

The actuarial gain in 2013 and loss in 2012 primarily relates to changes in the discount rate used to measure the benefit obligation.

Accumulated Benefit Obligation

The projected benefit obligation, accumulated benefit obligations and fair value of plan assets were as follows for September 30:

	2013	2012
	<i>(In Thousands)</i>	
Projected benefit obligation	\$ 179,605	\$ 199,526
Accumulated benefit obligation	179,605	199,526
Fair value of plan assets	136,660	132,485

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Retirement Benefit Plans (continued)

The following table provides the components of the net periodic benefit cost for the plan for the years ended September 30:

	Pension Benefits	
	2013	2012
	<i>(In Thousands)</i>	
Components of net periodic benefit cost		
Interest cost	\$ 7,841	\$ 8,464
Expected rate of return on plan assets	(9,348)	(9,269)
Recognized net actuarial loss	2,740	1,365
Net periodic benefit cost	<u>\$ 1,233</u>	<u>\$ 560</u>

Assumptions

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

	Pension Benefits	
	2013	2012
Discount rate	4.90%	4.0%

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

	Pension Benefits	
	2013	2012
Discount rate	4.00%	5.20%
Expected long-term return on plan assets	6.75	6.75

Measurement Date

The measurement date used to determine pension benefits is September 30 in 2013 and 2012.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Retirement Benefit Plans (continued)

Plan Assets

The asset allocations of the Hospital's pension plan at September 30 are as follows:

	Target Allocation	Percentage of Plan Assets	
	2014	2013	2012
Asset category:			
Equity securities	35%	40%	22%
Debt securities	39	43	61
Alternative investments	26	17	17
Total	100%	100%	100%

The pension assets carried at fair value as of September 30, 2013 and 2012, are classified in the following tables in one of the three categories described in footNote 15 (in thousands):

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 1,441	\$ –	\$ –	\$ 1,441
U.S. equity securities	29,960	–	–	29,960
International equity securities	25,111	–	–	25,111
Fixed income:				
U.S. government	19,474	–	–	19,474
Corporate debt	29,606	–	–	29,606
International government	7,720	–	–	7,720
Hedge funds:				
Long/short equity	–	9,495	–	9,495
Multi strategy/other	–	–	10,505	10,505
Real estate	3,348	–	–	3,348
Total investments as of September 30, 2013	\$ 116,660	\$ 9,495	\$ 10,505	\$ 136,660

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Retirement Benefit Plans (continued)

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 4,558	\$ –	\$ –	\$ 4,558
U.S. equity securities	19,674	–	–	19,674
International equity securities	12,459	–	–	12,459
Fixed income:				
U.S. government	28,193	–	–	28,193
Corporate debt	37,263	–	–	37,263
International government	10,275	–	–	10,275
Hedge funds:				
Long/short equity	–	8,764	–	8,764
Multi strategy/other	–	–	8,689	8,689
Real estate	2,610	–	–	2,610
Total investments as of September 30, 2012	<u>\$ 115,032</u>	<u>\$ 8,764</u>	<u>\$ 8,689</u>	<u>\$ 132,485</u>

The following is a rollforward of the pension assets classified as Level 3 of the valuation hierarchy as described in Note 15:

Fair value at September 30, 2011	\$ 6,806
2012 realized gains and losses	2,931
2012 unrealized gains and losses	207
2012 purchases	8,500
2012 sales	(9,755)
Fair value at September 30, 2012	<u>8,689</u>
2013 unrealized gains and losses	666
2013 purchases	1,150
Fair value at September 30, 2013	<u><u>\$ 10,505</u></u>

The Hospital's investment strategy for its pension assets balances the liquidity needs of the pension plan with the long-term return goals necessary to satisfy future pension obligations. The target asset allocation seeks to capture the equity premium granted by the capital markets over the long-term while ensuring security of principal to meet near term expenses and obligations through the fixed income allocation. The allocations of the investment pool to various sectors of the markets are designed to reduce volatility in the portfolio.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Retirement Benefit Plans (continued)

The Hospital's pension portfolio return assumption of 6.75% is based on the targeted weighted-average return of comparative market indices for the asset classes represented in the portfolio and discounted for pension expenses.

Cash Flows

Contributions: The Hospital and its affiliates expected contribution to the defined benefit pension plan in fiscal year 2014 is approximately \$7.2 million.

Estimated Future Benefit Payments: The Hospital and its affiliates expect to pay the following benefit payments as appropriate in thousands:

2014	\$	7,529
2015		7,723
2016		8,113
2017		8,582
2018		9,331
2019 to 2024		55,051

9. Professional Liability and Self-Insurance Arrangements

Yale-New Haven Hospital (YNHH) and a number of academic medical centers are shareholders in The Medical Center Insurance Company, Ltd. (the Captive). The Captive was formed to insure for professional and comprehensive general liability risks of its shareholders and certain affiliated entities of the shareholders. On October 1, 1997, the Hospital was added to the YNHH program as an additional insured. The Captive and its wholly-owned subsidiary write direct insurance and reinsurance for varying levels of per claim limit exposure. The Captive has reinsurance coverage from outside reinsurers for amounts above the per claim limits. Premiums are based on modified claims made coverage and are actuarially determined based on actual experience of the Hospital, and the Captive. The Hospital pays insurance premiums to YNHHSC.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Professional Liability and Self-Insurance Arrangements (continued)

The estimate for modified claims-made professional liabilities and the estimate for incidents that have been incurred but not reported aggregated approximately \$44.8 million and \$54.7 million at September 30, 2013 and 2012, respectively. The undiscounted estimate for incidents that have been incurred but not reported aggregated approximately \$13.6 million and \$13.9 million at September 30, 2013 and 2012, respectively, and is included in professional insurance liabilities in the accompanying balance sheets at the actuarially determined present value of approximately \$12.1 million and \$12.1 million, respectively, based on a discount rate of 2.5% and 3.0% for the years ended September 30, 2013 and 2012, respectively.

The Hospital has recorded related insurance recoveries receivable of approximately \$32.7 million and \$42.5 million at September 30, 2013 and 2012, respectively, in consideration of the expected insurance recoveries for the total discounted modified claims-made insurance. The current portion of professional liabilities and the related insurance receivable represents an estimate of expected settlements and insurance recoveries over the next 12 months.

The Hospital's estimates for professional insurance liabilities are based upon complex actuarial calculations which utilize factors such as historical claims experience for the Hospital and related industry factors, trending models, estimates for the payment patterns of future claims and present value discount factors. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Revisions to estimated amounts resulting from actual experience differing from projected expectations are recorded in the period the information becomes known or when changes are anticipated.

10. Commitments and Contingencies

Various lawsuits and claims arising in the normal course of operations are pending or are in progress against the Hospital. Such lawsuits and claims are either specifically covered by insurance as explained in Note 9 or are deemed immaterial. While the outcome of these lawsuits cannot be determined at this time, management believes that any loss which may arise from these actions will not have a material adverse effect on the consolidated financial position or results of operations of BHHS.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

BHHS and its subsidiaries have various lease agreements, some of which provide for adjustments to future lease payments.

The Hospital has an irrevocable letter of credit with a bank to provide coverage to the State of Connecticut for workers' compensation claims. There were no amounts outstanding under this letter of credit during fiscal years 2013 and 2012.

The Hospital has obtained a surety bond to provide coverage to the State of Connecticut for unemployment compensation in 2012. There were no amounts outstanding in 2013 or 2012.

The Hospital has various lease agreements. Lease expense for the fiscal years 2013 and 2012, was approximately \$4.7 and \$4.3 million, respectively. Future minimum payments under these leases are as follows:

2014	\$ 4,051
2015	3,134
2016	2,982
2017	2,183
2018	1,411
Thereafter	12,156
	\$ 25,917

11. Functional Expenses

BHHS and its subsidiaries provide general health care services to residents within their geographic location, including pediatric care, cardiac catheterization and outpatient surgery. Net expenses related to providing these services for the years ended September 30 are as follows:

	2013	2012
	<i>(In Thousands)</i>	
Health care services	\$ 340,620	\$ 322,940
General and administrative	85,155	80,735
	\$ 425,775	\$ 403,675

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Related Party Transactions

BHHS purchased certain services for the year ended September 30 from YNHHS as follows:

	2013	2012
	<i>(In Thousands)</i>	
Operating expenses:		
Professional and general liability insurance	\$ 292	\$ 2,182
Information systems	21,811	15,798
System business office	9,289	7,050
Other business services	26,777	20,147
	\$ 58,169	\$ 45,177

BHHS funds certain capital assets purchased by YNHHS. Included in prepaid expenses and other assets were approximately \$35.0 million at September 30, 2013, and approximately \$18.8 million at September 30, 2012.

Included in depreciation and amortization expense for each of the years ended September 30, 2013 and 2012, is approximately \$2.2 million and \$1.0 million, respectively, of costs allocated from YNHHS for shared capital projects.

Included in supplies and other expenses are amounts paid to YNHHS for physician related strategic support of approximately \$13.0 million and \$13.4 million for the years ended September 30, 2013 and 2012, respectively.

Accounts payable to related organizations is included in accrued expenses in the accompanying consolidated balance sheets for the year ended September 30 as follows:

	2013	2012
	<i>(In Thousands)</i>	
Accounts receivable:		
Yale-New Haven Hospital	\$ 837	\$ 1,501
	\$ 837	\$ 1,501
Accounts payable:		
YNHHS	\$ 15,710	\$ 15,750
Northeast Medical Group	1,355	2,430
Greenwich Hospital	34	-
	\$ 17,099	\$ 18,180

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Other Revenue

Other revenue consisted of the following (in thousands):

	Year Ended September 30	
	2013	2012
Cafeteria and vending	\$ 1,934	\$ 1,793
Parking income	1,447	1,409
Net assets released from restrictions for operations	6,346	4,975
Electronic health records incentive payment	3,587	1,725
Pediatric ancillary services	9,569	5,901
Other	3,325	3,247
	\$ 26,208	\$ 19,050

The American Recovery and Reinvestment Act of 2009 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 beginning in 2011 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 available to providers that adopt, implement, or upgrade certified EHR technology. In subsequent years, providers must demonstrate meaningful use of such technology to qualify for additional Medicaid incentive payments. Hospitals that do not successfully demonstrate meaningful use of EHR technology are subject to payment penalties or downward adjustments to their Medicare payments beginning in federal fiscal year 2015.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Other Revenue (continued)

BHHS uses a grant accounting model to recognize revenue for the Medicare and Medicaid EHR incentive payments. Under this accounting policy, EHR incentive payment revenue is recognized when BHHS is reasonably assured that the EHR meaningful use criteria for the required period of time were met and that the grant revenue will be received. Medicare EHR incentive payment revenue was approximately \$2.6 million for the year ended September 30, 2013 and Medicaid EHR incentive payment revenue was approximately \$1.0 million and \$1.7 million, respectively for the years ended September 30, 2013 and 2012. EHR incentive payment revenue is included in other revenue in the accompanying consolidated statement of operations. Income from incentive payments is subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated. Additionally, BHHS's attestation of compliance with the meaningful use criteria is subject to audit by the federal government.

14. Non-Operating Gains and Losses, Net

Non-operating gains and losses consisted of the following (in thousands)

	Year Ended September 30	
	2013	2012
Income from investments and other, net	\$ 447	\$ 2,357
Change in unrealized gains and losses on investments	3,522	1,606
Loss on refunding and refinancing of debt	—	(1,799)
	<u>\$ 3,969</u>	<u>\$ 2,164</u>

15. Fair Values Measurements

In determining fair value, BHHS utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Hospital also considers nonperformance risk in the overall assessment of fair value.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Fair Values Measurements (continued)

ASC 820-10, *Fair Value Measurements*, establishes a three tier valuation hierarchy for fair value disclosure purposes. This hierarchy is based on the transparency of the inputs utilized for the valuation. The three levels are defined as follows:

- **Level 1:** Quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities. This established hierarchy assigns the highest priority to Level 1 assets.
- **Level 2:** Observable inputs that are based on data not quoted in active markets, but corroborated by market data.
- **Level 3:** Unobservable inputs that are used when little or no market data is available. The Level 3 inputs are assigned the lowest priority.

Financial assets carried at fair value as of September 30, 2013 and 2012, are classified in the following tables in two of the three categories described above (in thousands):

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 30,636	\$ —	\$ —	\$ 30,636
Money market funds	7,737	—	—	7,737
U.S. equity securities	7,004	—	—	7,004
International equity securities	7,224	—	—	7,224
Fixed income:				
U.S. government	18,018	—	—	18,018
Corporate debt	3,733	—	—	3,733
International government	4,022	2,514	—	6,536
Interest in Yale University endowment pool	—	—	56,188	56,188
Investments at fair value	\$ 78,374	\$ 2,514	\$ 56,188	\$ 137,076
Common collective trusts				9,023
Alternative investments				1,943
Investments not at fair value				10,966
Total investments as of September 30, 2013				\$ 148,042

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Fair Values Measurements (continued)

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 16,072	\$ —	\$ —	\$ 16,072
Money market funds	7,930	—	—	7,930
Mutual Funds	145	—	—	145
U.S. equity securities	5,840	—	—	5,840
International equity securities	5,304	—	—	5,304
Fixed income:				
U.S. government	23,353	—	—	23,353
Corporate debt	2,362	—	—	2,362
International government	3,634	2,311	—	5,945
Interest in Yale University endowment pool	—	—	46,760	46,760
Investments at fair value	<u>\$ 64,640</u>	<u>\$ 2,311</u>	<u>\$ 46,760</u>	<u>\$ 113,711</u>
Common collective trusts				12,321
Alternative investments				8,969
Investments not at fair value				<u>21,290</u>
Total investments as of September 30, 2012				<u>\$ 135,001</u>

The following is a rollforward of assets classified as Level 3 of the valuation hierarchy:

Interest in Yale University Endowment Pool:	
Fair value at September 30, 2011	\$ 23,354
2012 unrealized gains	17,682
2012 purchases	5,724
Fair value at September 30, 2012	<u>46,760</u>
2013 unrealized gains	<u>9,428</u>
Fair value at September 30, 2013	<u>\$ 56,188</u>

Fair values of BHHS's debt are based on current borrowing rates for similar types of debt using undiscounted cash flow analyses. The fair value of the long-term debt at September 30, 2013 and 2012 is \$57.8 million and \$48.0 million, respectively. The fair value of long-term debt is classified as Level 2 in the fair value hierarchy as it uses a combination of quoted market prices and valuation based on current market rates.

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

16. Subsequent Events

Subsequent events have been evaluated through December 23, 2013 which is the date the financial statements were available to be issued. No events, other than those disclosed below, have occurred that require disclosure or adjustment of the financial statements.

In November 2013, the Hospital entered into an arrangement with a developer to construct a 120,000 square foot medical office building and adjacent garage in Fairfield County, CT. The arrangement contains provisions for the Hospital to begin leasing the property for a 25-year period beginning in April 2016. Management has evaluated the terms of the arrangement and anticipates the project will be recorded as a capital lease. Upon completion, management estimates the capital lease obligation will be approximately \$102 million.

Supplementary Information

Report of Independent Auditors on Supplementary Information

The Board of Directors
Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

We have audited, in accordance with auditing standards generally accepted in the United States, the consolidated financial statements of Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries as of and for the years ended September 30, 2013 and 2012, and have issued an unmodified opinion thereon dated December 23, 2013. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating balance sheet and consolidating statement of operations and changes in net assets are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statement as a whole.

Ernst & Young LLP

December 23, 2013

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Consolidating Balance Sheet (In Thousands)

September 30, 2013

	Hospital	Foundation	Eliminating Entries	Obligated Group	Parent	Properties	Eliminations	Total
Assets								
Current assets:								
Cash and cash equivalents	\$ 30,127	\$ 380	\$ –	\$ 30,507	\$ 125	\$ 4	\$ –	\$ 30,636
Short term investments	33,642	30,665	–	64,307	–	–	–	64,307
Accounts receivable	51,432	–	–	51,432	–	–	–	51,432
Professional liabilities insurance recoveries receivable –current portion	10,552	–	–	10,552	–	–	–	10,552
Other current assets	17,710	650	(520)	17,840	2,779	4	(2,868)	17,755
Total current assets	143,463	31,695	(520)	174,638	2,904	8	(2,868)	174,682
Long-term investments	24,082	29,017	–	53,099	–	–	–	53,099
Interest in Bridgeport Hospital Foundation, Inc.	60,014	–	(60,014)	–	–	–	–	–
Professional liabilities insurance recoveries receivable – non-current	22,167	–	–	22,167	–	–	–	22,167
Other assets	30,658	319	–	30,977	908	–	–	31,885
Goodwill	17,217	–	–	17,217	–	–	–	17,217
Property, plant and equipment:								
Land, buildings, and improvements	122,841	–	–	122,841	–	1,467	–	124,308
Equipment	285,792	20	–	285,812	–	–	–	285,812
	408,633	20	–	408,653	–	1,467	–	410,120
Less accumulated depreciation and amortization	(285,402)	(18)	–	(285,420)	–	(353)	–	(285,773)
	123,231	2	–	123,233	–	1,114	–	124,347
Construction in progress	19,477	–	–	19,477	–	–	–	19,477
	142,708	2	–	142,710	–	1,114	–	143,824
Total assets	\$ 440,309	\$ 61,033	\$ (60,534)	\$ 440,808	\$ 3,812	\$ 1,122	\$ (2,868)	\$ 442,874

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Consolidating Balance Sheet (continued)
(In Thousands)

September 30, 2013

	Hospital	Foundation	Eliminating Entries	Obligated Group	Parent	Properties	Eliminations	Total
Liabilities and net assets								
Current liabilities:								
Accounts payable	\$ 16,363	\$ –	\$ –	\$ 16,363	\$ –	\$ –	\$ –	\$ 16,363
Accrued expenses	49,185	102	–	49,287	1,339	119	(2,868)	47,877
Current portion of long-term debt	32,205	–	–	32,205	–	–	–	32,205
Professional liabilities – current portion	10,552	–	–	10,552	–	–	–	10,552
Other current liabilities	5,306	520	(520)	5,306	–	–	–	5,306
Total current liabilities	113,611	622	(520)	113,713	1,339	119	(2,868)	112,303
Long-term debt, net of current portion	49,202	–	–	49,202	–	–	–	49,202
Accrued pension obligation	36,720	–	–	36,720	6,225	–	–	42,945
Professional liabilities	34,291	–	–	34,291	–	–	–	34,291
Other long-term liabilities	30,625	397	–	31,022	–	–	–	31,022
Total liabilities	264,449	1,019	(520)	264,948	7,564	119	(2,868)	269,763
Net assets:								
Unrestricted	123,039	30,422	(30,422)	123,039	(3,752)	1,003	–	120,290
Temporarily restricted	32,033	14,212	(14,212)	32,033	–	–	–	32,033
Permanently restricted	20,788	15,380	(15,380)	20,788	–	–	–	20,788
Total net assets	175,860	60,014	(60,014)	175,860	(3,752)	1,003	–	173,111
Total liabilities and net assets	\$ 440,309	\$ 61,033	\$ (60,534)	\$ 440,808	\$ 3,812	\$ 1,122	\$ (2,868)	\$ 442,874

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Consolidating Statement of Operations and Changes in Net Assets
(In Thousands)

Year Ended September 30, 2013

	Hospital	Foundation	Eliminating Entries	Obligated Group	Parent	Properties	Eliminations	Total
Operating revenue:								
Net patient service revenue	\$ 433,811	\$ -	\$ -	\$ 433,811	\$ -	\$ -	\$ -	\$ 433,811
Less: Provision for bad debts	(14,984)	-	-	(14,984)	-	-	-	(14,984)
Net patient service revenue, less provision for bad debts	418,827	-	-	418,827	-	-	-	418,827
Other revenue	22,885	3,064	-	25,949	133	155	(29)	26,208
Total operating revenue	441,712	3,064	-	444,776	133	155	(29)	445,035
Operating expenses:								
Salaries and benefits	195,993	-	-	195,993	-	-	-	195,993
Supplies and other expenses	187,754	3,064	-	190,818	13,230	212	(29)	204,231
Depreciation and amortization	22,794	-	-	22,794	-	64	-	22,858
Insurance	1,028	-	-	1,028	-	-	-	1,028
Interest	1,665	-	-	1,665	-	-	-	1,665
Total operating expenses	409,234	3,064	-	412,298	13,230	276	(29)	425,775
Income (loss) from operations	32,478	-	-	32,478	(13,097)	(121)	-	19,260
Non-operating gains and losses, net	3,969	1,825	(1,825)	3,969	-	-	-	3,969
Excess (deficiency) of revenue over expenses	36,447	1,825	(1,825)	36,447	(13,097)	(121)	-	23,229

Bridgeport Hospital & Healthcare Services, Inc. and Subsidiaries

Consolidating Statement of Operations and Changes in Net Assets (continued) (In Thousands)

Year Ended September 30, 2013

	Hospital	Foundation	Eliminating Entries	Obligated Group	Parent	Properties	Eliminations	Total
Unrestricted net assets:								
Excess (deficiency) of revenue over expenses	\$ 36,447	\$ 1,825	\$ (1,825)	\$ 36,447	\$ (13,097)	\$ (121)	\$ –	\$ 23,229
Net assets released from restrictions used for capital acquisitions	879	–	–	879	–	–	–	879
Transfers to/from BHHS	(12,995)	–	–	(12,995)	12,995	–	–	–
Transfers from YNHHS	900	–	–	900	–	–	–	900
Other transfers	444	444	(444)	444	–	–	–	444
Change in pension obligation	22,810	–	–	22,810	–	–	–	22,810
Increase (decrease) in unrestricted net assets	48,485	2,269	(2,269)	48,485	(102)	(121)	–	48,262
Temporarily restricted net assets:								
Net changes in interest in the Foundation:								
Net assets released from restrictions used for operations	(3,064)	–	3,064	–	–	–	–	–
Change in unrealized gains and losses on investments	600	–	(600)	–	–	–	–	–
Bequests, contributions, and grants	6,057	–	(6,057)	–	–	–	–	–
Net realized investment gains and losses	374	–	(374)	–	–	–	–	–
Transfers to the Hospital	(1,765)	–	1,765	–	–	–	–	–
Other changes in net assets	475	–	(475)	–	–	–	–	–
Net assets from restrictions used for operations	(3,282)	(3,064)	–	(6,346)	–	–	–	(6,346)
Net assets released from restrictions used for capital acquisitions	(879)	–	–	(879)	–	–	–	(879)
Change in unrealized gains and losses on investments	1,730	600	–	2,330	–	–	–	2,330
Bequests, contributions, and grants	81	6,057	–	6,138	–	–	–	6,138
Net realized investment gains and losses	668	374	–	1,042	–	–	–	1,042
Other changes in net assets	441	(543)	1,018	916	–	–	–	916
Transfers from the Foundation and other transfers	1,765	(1,765)	–	–	–	–	–	–
Increase (decrease) in temporarily restricted net assets	3,201	1,659	(1,659)	3,201	–	–	–	3,201
Permanently restricted net assets:								
Bequests, contributions, and grants	916	907	(907)	916	–	–	–	916
Increase (decrease) in permanently restricted net assets	916	907	(907)	916	–	–	–	916
Increase (decrease) in net assets	52,602	4,835	(4,835)	52,602	(102)	(121)	–	52,379
Net assets at beginning of year	123,258	55,179	(55,179)	123,258	(3,650)	1,124	–	120,732
Net assets (deficiency) at end of year	\$ 175,860	\$ 60,014	\$ (60,014)	\$ 175,860	\$ (3,752)	\$ 1,003	\$ –	\$ 173,111

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