

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
SEPTEMBER 30, 2013 AND 2012

JOHNSON MEMORIAL HOSPITAL

CONTENTS

Independent Auditors' Report	1-2
---	-----

Consolidated Financial Statements

Consolidated Balance Sheets	3-4
Consolidated Statements of Operations	5
Consolidated Statements of Changes in Net Assets (Deficit).....	6
Consolidated Statements of Cash Flows.....	7-8

Notes to Consolidated Financial Statements	9-41
---	------

Independent Auditors' Report on Supplementary Information	42
--	----

Supplementary Information

Consolidating Balance Sheets as of September 30, 2013	43-45
Consolidating Balance Sheets as of September 30, 2012.....	46-48
Consolidating Statements of Operations for the year ending September 30, 2013	49-50
Consolidating Statements of Operations for the year ending September 30, 2012	51-52



INDEPENDENT AUDITORS' REPORT

Board of Directors
Johnson Memorial Hospital

We have audited the accompanying consolidated financial statements of Johnson Memorial Hospital, which comprise the balance sheets as of September 30, 2013 and 2012, and the related statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Johnson Memorial Hospital as of September 30, 2013 and 2012, and the results of its operations, changes in net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

The accompanying consolidated financial statements have been prepared assuming that the Hospital will continue as a going concern. As described in Note 1, for the year ended September 30, 2013, the Hospital experienced a loss of \$4,622,272 and had current liabilities that exceeded current assets by \$14,836,839. The Hospital is a party to a credit agreement and mortgage that require certain financial and non-financial covenants be maintained. The Hospital failed certain covenants during the year ended September 30, 2013 and defaulted on certain payments due on its mortgage. The mortgage and line of credit are callable on demand by the lenders. In addition, certain creditors filed a motion to convert the Bankruptcy Case to Chapter 7 of the Bankruptcy Code after the October 1, 2013 payments to the creditors were not made. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Marcum LLP

Hartford, CT
January 17, 2014

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2013 AND 2012

	2013	2012
Assets		
Current Assets		
Cash and cash equivalents	\$ 210,152	\$ 819,327
Patients accounts receivable, net of allowances for uncollectible accounts, \$3,725,000 in 2013 and \$2,702,000 in 2012	7,632,109	8,403,783
Other receivables	1,691,228	222,529
Inventories	1,317,470	1,254,591
Prepaid expenses and other current assets	<u>899,407</u>	<u>853,062</u>
Total Current Assets	<u>11,750,366</u>	<u>11,553,292</u>
Assets Whose Use is Limited		
Beneficial interests in perpetual trusts	3,729,727	3,616,492
Restricted cash and board designated investments	268,338	363,097
Investments permanently restricted by donor	<u>843,587</u>	<u>843,587</u>
Total Assets Whose Use is Limited	<u>4,841,652</u>	<u>4,823,176</u>
Other Assets		
Property, plant and equipment, net	17,066,172	19,606,953
Investments in joint ventures	3,165,915	3,106,905
Deferred financing costs, net	172,864	356,845
Other noncurrent assets	<u>476,000</u>	<u>445,000</u>
Total Other Assets	<u>20,880,951</u>	<u>23,515,703</u>
	<u>\$ 37,472,969</u>	<u>\$ 39,892,171</u>

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

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATED BALANCE SHEETS (CONTINUED)
SEPTEMBER 30, 2013 AND 2012

	2013	2012
Liabilities and Net Assets (Deficit)		
Current Liabilities		
Trade accounts payable	\$ 5,189,596	\$ 3,400,553
Accrued payroll and related costs	2,048,896	2,172,911
Current portion of payments due under plan of reorganization	1,947,500	997,500
Senior debt under revolving line of credit	2,208,858	3,504,213
Current portion of mortgage payable	11,987,500	342,500
Current portion of subordinated and other debt	457,587	100,583
Current portion of capital lease obligations	14,365	61,820
Estimated amounts due to third-party reimbursement agencies	2,564,571	1,272,580
Other current liabilities	168,332	116,508
Total Current Liabilities	<u>26,587,205</u>	<u>11,969,168</u>
Long-Term Obligations		
Due to affiliate corporations	2,317,342	1,817,168
Payments due under plan of reorganization - less current portion	3,930,808	5,505,445
Mortgage payable - less current portion	--	11,816,250
Subordinated debt - less current portion	125,022	231,464
Other long-term debt	2,350,000	1,300,000
Obligations under capital lease - less current portion	45,579	58,370
Self-insurance liabilities and reserves for incurred but not reported professional liability claims	641,424	1,141,100
Other liabilities	604,927	769,553
Total Long-Term Obligations	<u>10,015,102</u>	<u>22,639,350</u>
Total Liabilities	<u>36,602,307</u>	<u>34,608,518</u>
Net Assets (Deficit)		
Unrestricted	(3,971,579)	560,928
Temporarily restricted	268,927	262,646
Permanently restricted	4,573,314	4,460,079
Total Net Assets	<u>870,662</u>	<u>5,283,653</u>
	<u>\$ 37,472,969</u>	<u>\$ 39,892,171</u>

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

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

	2013	2012
Operating Revenue		
Net patient service revenue	\$ 68,075,182	\$ 69,334,641
Provision for bad debts	<u>4,584,989</u>	<u>3,773,454</u>
Net patient service revenue less provision for bad debts	63,490,193	65,561,187
Grant and other income	324,460	308,671
Net assets released from restriction	<u>443,523</u>	<u>25,552</u>
Total Operating Revenue	<u>64,258,176</u>	<u>65,895,410</u>
Expenses		
Salaries	30,381,654	31,433,170
Employee benefits	6,806,518	7,370,190
Professional fees and outsourced staffing	4,548,191	3,365,845
Depreciation and amortization	3,115,981	3,213,542
Purchased services	3,902,675	3,631,422
Supplies, drugs and patient care	8,704,335	7,130,721
Leases and service contracts	1,563,348	1,677,716
Occupancy costs	3,419,322	3,111,685
Insurance	1,092,058	1,178,515
Other expenses	4,210,400	4,696,731
Interest	<u>1,368,245</u>	<u>1,495,715</u>
Total Expenses	<u>69,112,727</u>	<u>68,305,252</u>
Loss from Operations	<u>(4,854,551)</u>	<u>(2,409,842)</u>
Nonoperating Revenue		
Investment income	158,800	177,006
Gain on sale of equipment	1,200	3,196
Equity earnings in joint ventures	<u>72,279</u>	<u>250,254</u>
	<u>232,279</u>	<u>430,456</u>
Deficiency of Revenue over Expenses	<u>\$ (4,622,272)</u>	<u>\$ (1,979,386)</u>

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

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (DEFICIT)

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
Unrestricted Net Assets		
Deficiency of revenues over expenses	\$ (4,622,272)	\$ (1,979,386)
Net asset transfer from affiliate	--	74,638
Net assets released from restriction for purchase of property and equipment	<u>89,765</u>	<u>552,037</u>
Change in Unrestricted Net Assets	<u>(4,532,507)</u>	<u>(1,352,711)</u>
Temporarily Restricted Net Assets		
Grants and contributions	539,569	518,618
Net assets released from restriction	<u>(533,288)</u>	<u>(577,589)</u>
Change in Temporarily Restricted Net Assets	<u>6,281</u>	<u>(58,971)</u>
Permanently Restricted Net Assets		
Increase in fair value of beneficial interests in perpetual trusts	<u>113,235</u>	<u>450,770</u>
Change in Net Assets	(4,412,991)	(960,912)
Net Assets - Beginning	<u>5,283,653</u>	<u>6,244,565</u>
Net Assets - End	<u>\$ 870,662</u>	<u>\$ 5,283,653</u>

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

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

	2013	2012
Cash Flows From Operating Activities and Reorganization Items		
Change in net assets	\$ (4,412,991)	\$ (960,912)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	3,115,981	3,213,542
Accretion of asset retirement obligation	10,374	16,643
Provision for uncollectible accounts	4,584,989	3,773,454
Equity earnings in joint ventures	(72,279)	(250,254)
Gain on disposal of equipment	(1,200)	(3,196)
Change in net realized and unrealized gains on investments	(113,235)	(450,770)
Changes in assets and liabilities:		
Patient accounts receivable	(3,813,315)	(4,635,797)
Other receivables	(1,468,699)	1,192,891
Prepaid expenses and other current assets	(46,345)	124,639
Inventories	(62,879)	(38,096)
Restricted cash and board designated investments	94,759	154,310
Other noncurrent assets	(31,000)	--
Restricted grants and contributions	(539,569)	(518,618)
Accounts payable and accrued expenses	1,789,043	724,503
Accrued payroll and related costs	(124,015)	261,905
Estimated amounts due to third-party reimbursement agencies	1,291,991	6,276
Other liabilities	(108,707)	(69,326)
Self-insurance liabilities	(499,676)	(434,712)
Payments due under plan of reorganization	(624,637)	(952,981)
Net Cash (Used in) Provided by Operating Activities and Reorganization Items	(1,031,410)	1,153,501
Cash Flows From Investing Activities		
Capital expenditures	(391,219)	(1,143,798)
Net Cash Used in Investing Activities	(391,219)	(1,143,798)

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

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

	2013	2012
Cash Flows From Financing Activities		
Restricted grants and contributions	\$ 539,569	\$ 518,618
Principal payments on mortgage and subordinated debt	(270,688)	(437,603)
Proceeds from other long-term debt	1,400,000	1,300,000
Net payments on revolving line of credit	(1,295,355)	(1,146,973)
Principal payments on capital lease obligations	(60,246)	(89,881)
Payments from (to) affiliates	<u>500,174</u>	<u>(248,253)</u>
Net Cash Provided by (Used in) Financing Activities	<u>813,454</u>	<u>(104,092)</u>
Net Change in Cash and Cash Equivalents	(609,175)	(94,389)
Cash and Cash Equivalents - Beginning	<u>819,327</u>	<u>913,716</u>
Cash and Cash Equivalents - Ending	<u>\$ 210,152</u>	<u>\$ 819,327</u>
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	<u>\$ 354,510</u>	<u>\$ 1,036,354</u>

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

JOHNSON MEMORIAL HOSPITAL
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION

ORGANIZATION

Johnson Memorial Hospital (the Hospital) is an acute care hospital located in Stafford Springs, Connecticut. The Hospital is licensed for 92 beds and provides a broad range of inpatient and outpatient services primarily throughout the Hartford and Tolland Connecticut counties. Admitting physicians are primarily practitioners in this same geographic area. The Hospital has controlling interests in Johnson Professional Associates, P.C. (JPA) and Johnson Memorial Hospital Development Fund, Inc. (Development). The Hospital is a subsidiary of Johnson Memorial Medical Center (the Corporation), a not-for-profit, non-stock holding company. The other subsidiaries of the Corporation are Johnson Health Care, Inc. (Health Care), Home & Community Health Services, Inc. (Home and Community) and Johnson Evergreen Corporation (Evergreen), which are not-for-profit companies, and WellCare, Inc., a taxable entity.

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

EMERGENCE FROM BANKRUPTCY

As a result of the Hospital's severe financial operating deficits, management determined it would be unable to pay its obligations in the normal course of business during fiscal year 2009 or service its debt in a timely fashion. On November 4, 2008, the Hospital, the Corporation and Evergreen, filed voluntary petitions for relief under Chapter 11 (Chapter 11 Proceedings) of the U.S. Bankruptcy Code (Bankruptcy Code) in the U.S. Bankruptcy Court for District of Connecticut, Hartford Division (Bankruptcy Court). This generally delayed payments of liabilities incurred prior to filing those petitions while the Hospital developed a plan of reorganization that was satisfactory to its creditors, and allowed it to continue as a going concern.

On August 11, 2010, the Bankruptcy Court confirmed the Hospital's plan of reorganization which was subject to the Hospital's satisfaction of a number of conditions precedent. One of the conditions precedent was that the Hospital, the Corporation, and Evergreen (collectively the Debtors) were required to obtain a line of credit of at least \$6 million. On September 30, 2010, the plan of reorganization became effective when the Debtors received financing under an \$8 million line of credit and all other material conditions precedent to the plan becoming binding were resolved. The Bankruptcy Court issued a final decree on December 29, 2010.

There was no change in control as the Hospital's Board of Directors immediately prior to the confirmation of the plan retained control upon emergence from the Chapter 11 proceedings. Therefore, the Hospital did not adopt fresh-start reporting.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

As of September 30, 2013 and 2012, liabilities compromised by the confirmed plan have been recorded at the present values of amounts to be paid, determined at the interest rate of 6.75%.

The Hospital's confirmed plan provided for the following:

Secured Debt - The Hospital's secured debt with a bank (secured by a first mortgage lien on land and buildings located in Stafford Springs, Connecticut and a blanket lien on all furniture, fixtures, and equipment) was reinstated as such maturity existed before any default, and is payable in quarterly installments of \$85,625 through January 1, 2048. The Hospital will also remain obligated as guarantor of the Corporation's and Evergreen's secured debt in the amounts of \$3,001,081 and \$14,213,697, respectively, as of September 30, 2013.

Other Secured Debt – The Hospital's loan to finance information technology equipment was restructured to be paid in 60 monthly installments of \$10,000, including interest. The carrying value of this compromised debt was \$232,609 and \$332,047 as of September 30, 2013 and 2012, respectively.

Priority and Administrative Claims – All priority and administrative claims will be paid as allowed by the Court.

Trade and Other Miscellaneous Claims - The holders of approximately \$11 million of trade and other miscellaneous claims are entitled to receive \$705,232 on the effective date, \$256,025 on the first anniversary of the effective date, \$488,775 on the second anniversary of the effective date and \$954,275 on the each of the third, fourth, and fifth anniversaries of the effective date. The distribution could increase if the Hospital receives electronic medical record stimulus funding or if there is a change in control.

The holders of approximately \$145,000 of convenience claims are entitled to receive 50% of their allowed claim. Unexpired leases and executory contracts not rejected by the Hospital are paid according to their original or negotiated terms.

Pension Benefit Guaranty Corporation (PBGC) Claims - The PBGC was entitled to receive \$730,402 on the effective date, \$266,475 on the first anniversary of the effective date, \$508,725 on the second anniversary of the effective date and \$993,225 on the each of the third, fourth, and fifth anniversaries of the effective date. The distribution could increase if the Hospital receives electronic medical record stimulus funding, if there is a change in control, or if the Hospital receives litigation claim proceeds related to claims, rights or causes of action arising under Chapter 5 of the Bankruptcy Code. The Hospital has also recorded a liability of \$438,767 and \$411,023 as of September 30, 2013 and 2012, respectively, for the pension termination premium that is owed to the PBGC prior to October 1, 2016. If the premium is not paid by this date, the pension termination premium will increase to \$2 million.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

The Hospital failed to pay the amounts owed to the unsecured creditors of \$954,275 and the PBGC of \$993,225 that were due on October 1, 2013 and certain creditors filed a motion to convert the Bankruptcy Case to Chapter 7 of the Bankruptcy Code.

In addition, delinquent mortgage payments totaling approximately \$645,000 were past due under the secured mortgage as of September 30, 2013. People's Bank has the right to demand immediate payment of the \$11,987,500 balance of the mortgage which has been classified as a current liability at September 30, 2013.

AFFILIATION WITH SAINT FRANCIS CARE, INC.

On July 12, 2012, the Hospital, along with the Corporation and Evergreen (collectively, the Johnson Entities) entered into an affiliation agreement with Saint Francis Care, Inc. (Saint Francis), a Hartford, Connecticut based health system, designed to establish a long-term stable relationship between the two systems, allowing them to work together to maintain and strengthen the Corporation's operating viability and the Hospital's presence in the community as a community hospital, expand the array of health care services available, support the Hospital's medical staff, and enhance the Corporation's efforts to fulfill its mission. Saint Francis made an initial payment to the Johnson Entities of \$1,300,000 on the date of the affiliation agreement and made an additional payment of \$1,050,000 on October 1, 2012, both payments to be used by the Johnson Entities to satisfy outstanding claims owed under the reorganization plan (the Plan) to the Pension Benefit Guaranty Corporation and the unsecured creditors in classes A6 and B6 of the Plan.

In addition, Saint Francis was provided with the option, at its sole discretion, to make future annual payments of \$2,050,000 on the first day of October from 2013 through 2015 and a payment of \$500,000 on the first day of October 2016. The Johnson Entities will use these additional payments to satisfy the payment of claims due on these dates under the Plan. Saint Francis is required to notify the Corporation by June 1 of each year whether it will make the next succeeding additional payment. All payments made by Saint Francis under this agreement will constitute an unsecured loan. This loan will be payable in the event that the Corporation seeks the closing of an alternative transaction, but only if the proceeds of this alternative transaction exceed the amounts necessary to satisfy all other secured and unsecured debt owed by the Corporation, or breaches the exclusivity provisions granted to Saint Francis in the agreement.

In the event that the Johnson Entities breach the exclusivity provisions of the affiliation agreement, the Johnson Entities will be required to pay Saint Francis fees of \$250,000 for each payment made by Saint Francis to the Johnson Entities up to a maximum fee of \$1,000,000.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

The affiliation agreement provides Saint Francis with the right to cause the Johnson Entities to be merged with or into Saint Francis, to acquire all of the assets of the Johnson Entities, or to be the sole member of the Johnson Entities as long as Saint Francis assumes or satisfies all of the Johnson Entities' then-existing indebtedness.

Saint Francis did not exercise its option to make the payment of \$2,050,000 on October 1, 2013 and Saint Francis indicated that it will enter into a transaction to acquire some or all of the Johnson Entities or it will terminate the affiliation agreement. Saint Francis' acquisition is contingent upon the forgiveness of certain liabilities of the Johnson Entities by a bank and the unsecured creditors. It is uncertain whether the Hospital will be acquired by Saint Francis.

In the event that an agreement cannot be reached between Saint Francis, the bank, the unsecured creditors, the Johnson Entities would be forced to identify another buyer while possibly declaring bankruptcy.

In connection with the \$1,300,000 initial payment, Saint Francis was provided with the right to appoint three members to the Boards of Directors of Johnson Memorial Medical Center, Johnson Memorial Hospital, and Johnson Evergreen Corporation. For each additional payment made by Saint Francis, it will be provided with the right to add one additional board member to the aforementioned boards of directors. Saint Francis will not have the right to appoint a majority of the members of any of the aforementioned boards until all of the payments have been made under the terms of the affiliation agreement. After Saint Francis has made all of these payments, it will have the right to appoint the majority of the members of the boards subject to any necessary governmental approvals.

The affiliation agreement requires the Johnson Entities to obtain the consent of Saint Francis prior to the occurrence of the following events: merger, dissolution, dilution of Saint Francis' board representation, incurrence of certain additional debt, prepayment of debt, creation of liens, entering into lease obligations in excess of \$1 million, the sale or disposition of properties in excess of defined thresholds, distributions of cash, or the addition or termination of any material clinical service.

Saint Francis will provide medical leadership in the Hospital's oncology program, infectious disease program, hospitalist program and management services in both case management and psychiatry in an effort to help the Hospital to attract additional volume.

On May 17, 2013 the Johnson Entities amended the affiliation agreement with Saint Francis to include additional advances of up to \$1,000,000 to be used solely for general working capital purposes. Advances under this amendment are subject to interest effective October 1, 2013 at the prime rate plus 2%. As of September 30, 2013, \$350,000 was advanced to the Hospital.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

GOING CONCERN

The accompanying financial statements have been prepared assuming that the Hospital will continue as a going concern. For the year ended September 30, 2013, the Hospital experienced a loss of \$4,622,272 and had current liabilities that exceeded current assets by \$14,836,839. The Hospital is a party to a credit agreement and mortgage that require certain financial and non financial covenants be maintained. The Hospital failed certain covenants during the year ended September 30, 2013 and defaulted on certain payments due on its mortgage. The mortgage and line of credit are callable on demand by the lenders. In addition, certain creditors filed a motion to convert the Bankruptcy Case to Chapter 7 of the Bankruptcy Code after the October 1, 2013 payments to the creditors were not made. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Management executed an affiliation agreement with Saint Francis during the year ended September 30, 2012 and is pursuing an agreement for Saint Francis to acquire the Hospital in order to enhance the Hospital's ability to share in operational efficiencies and ensure that the Hospital continues as a going concern. During the year ending September 30, 2014, the Hospital will be introducing cost reductions in the budget, implementing changes in its employee health insurance benefit plan, and expects to receive reimbursement relief from the State of Connecticut and additional payments from the Federal government.

The ability of the Hospital to negotiate an agreement with Saint Francis that is acceptable to the bank and the unsecured creditors is uncertain and is contingent upon the forgiveness of certain debt. In the event that an agreement cannot be reached by these parties, the Hospital will be forced to identify another buyer while possibly declaring bankruptcy. The Hospital's continuation as a going concern is also ultimately dependent upon its future financial performance, which will be affected by general economic, competitive and other factors, many of which are beyond the Hospital's control. There can be no assurance that the Hospital's plans to ensure continuation as a going concern will be successful.

PRINCIPLES OF CONSOLIDATION AND PRESENTATION

The accompanying consolidated financial statements include the accounts of Johnson Memorial Hospital, Johnson Professional Associates, P.C., and Johnson Memorial Hospital Development Fund, Inc. JPA and Development are entities in which the Hospital has a controlling financial interest. All inter-company accounts have been eliminated in consolidation.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

CONSOLIDATION

ASC 810-25, *Consolidations*, requires a not-for-profit entity, among other things, to consolidate into its financial statements the financial results of another not-for-profit in which it has a controlling financial interest and to make certain disclosures. Reference is made to Note 2.

ASC 810-15 requires a for profit entity to be consolidated if an organization has the power through voting or similar rights to direct the economic activities of the entity.

NET ASSET CATEGORIES

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

Unrestricted – Unrestricted net assets represent available resources which can be used for general operations of the Hospital. Included in unrestricted net assets are assets set aside by the Board of Directors.

Temporarily Restricted – The Hospital reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in within the same year as received are reflected as unrestricted contributions in the accompanying statements of operations. At September 30, 2013 and 2012 the Hospital had temporarily restricted net assets of \$268,927 and \$262,646, respectively.

Permanently Restricted – Permanently restricted net assets represent contributions received with the donor restriction that the principal be invested in perpetuity and that income earned thereon is available for operations or a specific purpose.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

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).

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 to unrestricted 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.

PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable result from the health care services provided by the Hospital and JPA. 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 3 for additional information relative to net patient service revenue recognition and third-party payer programs.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

INVENTORIES

Inventories of drugs and supplies are stated at the lower of cost or market, determined 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) are included in the deficiency of revenues over expenses unless the income or loss is restricted by donor or law.

Unrealized gains and losses on investments on the Hospital's beneficial interest in perpetual trusts are recorded as changes in permanently restricted net assets.

INVESTMENT IN JOINT VENTURES

The Hospital has two joint ventures that it accounts for using the equity method. The changes in the Hospital's share in the equity of these joint ventures is recorded as a component of nonoperating revenue in the consolidated statements of operations.

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 ranging from 3 to 40 years.

Financial Accounting Standards Board ASC 410-20, *Accounting for Asset Retirement Obligations*, 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.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Conditional asset retirement obligations of \$334,927 and \$324,553 as of September 30, 2013 and 2012, respectively, were recorded in other liabilities on the balance sheets. These retirement obligations have been discounted at a rate of 6.75%. The undiscounted amounts of the obligations were \$346,000 at September 30, 2013 and 2012. There were no retirement obligations incurred or settled during 2013 or 2012. Reference is made to Note 14 regarding other environmental exposures.

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 2013 or 2012. Management believes that the Hospital will generate undiscounted cash flows that will at least hold the value in its long-lived assets at their current carrying values as a result of additional volume anticipated from new initiatives, projected additional relief from the State of Connecticut, and 2014 budgeted cost reductions that are expected to help the Hospital improve its cash flows.

NONOPERATING REVENUE

Activities, other than in connection with providing health care services, are considered to be nonoperating. Nonoperating revenue consists primarily of income on invested funds, gains on sales of equipment and the changes in the Hospital's share of equity of the joint ventures accounted for under the equity method.

DEFERRED FINANCING FEES

Deferred financing costs, which were incurred in connection with the debt, are being amortized over the term of the related debt. Amortization expense for deferred financing costs amounted to \$183,981 for the years ended September 30, 2013 and 2012.

DEFICIENCY OF REVENUE OVER EXPENSES

The statements of operations and changes in net assets include the deficiency of revenue over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from the deficiency of revenue 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) and permanent transfers of assets to and from affiliates for other than goods and services.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

INCOME TAXES

The Hospital and Development are not-for-profit corporations as defined in Section 501(c)(3) of the Internal Revenue Code, and therefore are exempt from federal and state income taxes, except on net income derived from unrelated business activities. JPA is a professional corporation that has experienced losses since inception and accordingly, no provisions for federal or state income taxes have been recorded.

The Hospital accounts for uncertainty in income tax positions in the consolidated financial statements by applying a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Management has analyzed the tax positions taken and has concluded that as of September 30, 2013, there are no uncertain tax positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements. The Hospital, Development, and JPA are subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Management believes that these organizations are no longer subject to income tax examinations prior to 2010.

ADVERTISING

The Hospital expenses advertising costs as incurred. Advertising expenses for the years ended September 30, 2013 and 2012 were \$40,673 and \$207,107, respectively.

BENEFICIAL INTEREST IN PERPETUAL TRUSTS

The Hospital is the beneficiary of several trust funds. Although the principal balances in the trust funds are permanently restricted, the income earned on the trust funds is unrestricted. The unrealized gains from the trust funds were \$113,235 in 2013 and \$450,770 in 2012 and are included in changes in permanently restricted net assets.

RECOGNITION OF GRANT REVENUE

Grants are generally considered to be exchange transactions in which the grantor requires the performance of specified activities. Entitlement to cost reimbursement grants is conditioned on the expenditure of funds in accordance with grant restrictions and, therefore, revenue is recognized to the extent of grant expenditures. Entitlement to performance based grants is conditioned on the attainment of specific performance.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

CHARITY CARE

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge, or at amounts less than its established rates. The Hospital does not pursue collection of amounts determined to be charity care. For the year ended September 30, 2013 the charges and costs related to charity care were \$310,398 and \$134,040 and for the year ended September 30, 2012, the charges and costs related to charity care were \$193,110 and \$77,541, respectively.

ESTIMATED MEDICAL MALPRACTICE AND WORKERS' COMPENSATION COSTS

The provision for estimated medical malpractice and workers' compensation claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

The Hospital accounts for its insurance claims and related insurance recoveries in accordance with the provisions of ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*, which indicates that health care entities should not net insurance recoveries against the related claim liabilities.

ADOPTION OF NEW ACCOUNTING STANDARD - 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 provision for bad debts 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 Hospital adopted the provisions of ASU 2011-07 for the year ended September 30, 2013 and retrospectively applied the presentation to the year ended September 30, 2012. See Note 3 for additional disclosures required by ASU 2011-07. There was no material impact to the Hospital's consolidated financial statements aside from the required changes in presentation.

RECLASSIFICATIONS

Certain amounts reported in the prior year's financial statements have been reclassified to conform to the current year's financial statements.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

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 consolidated financial statements. The Hospital evaluated events occurring subsequent to September 30, 2013 through January 17, 2014, the date on which the accompanying financial statements were available to be issued. During this period, there were no subsequent events that required disclosure or recognition in the financial statements, other than the Hospital's failure to make certain payments to the unsecured creditors and the PBGC on October 1, 2013.

NOTE 2 – CONSOLIDATED ENTITIES

JPA is a medical practice that is controlled by the Hospital. Although the Hospital does not have direct ownership interests in JPA, the Hospital has a controlling voting interest in the Board of JPA, thus enabling the Hospital to control the economic activities of JPA. Also, the Hospital provides funding to JPA to fund its operating losses.

Johnson Memorial Hospital Development Fund, Inc. is a not-for-profit organization that raises funds for the Hospital and other affiliates in which the Hospital has a controlling financial interest by virtue of control of its board of directors and the fact that substantially all of Development's assets are for the use of the Hospital.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 3 – NET REVENUE FROM SERVICES TO PATIENTS AND CHARITY CARE

The following table summarizes net revenue from services to patients during the years ended September 30, 2013 and 2012:

	2013	2012
Gross patient service revenue		
Inpatients	\$ 62,288,196	\$ 65,497,574
Outpatients	<u>105,897,974</u>	<u>96,065,249</u>
	<u>168,186,170</u>	<u>161,562,823</u>
Deductions		
Contractual and other allowances	99,976,948	92,150,641
Charity care provided free of charge - at cost	<u>134,040</u>	<u>77,541</u>
	<u>100,110,988</u>	<u>92,228,182</u>
Net patient service revenue	68,075,182	69,334,641
Provisions for bad debt	<u>4,584,989</u>	<u>3,773,454</u>
Net patient service revenue less provision for bad debts	<u>\$ 63,490,193</u>	<u>\$ 65,561,187</u>

Patient accounts receivable and revenues are recorded when patient services are performed. Amounts received from most payers are different from the established billing rates of the Hospital, and these differences are accounted for as allowances. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. For the years ended September 30, 2013 and 2012, the Hospital recorded approximately (\$469,000) and \$220,000, respectively, as a (decrease) increase to net patient service revenue as changes in estimates related to third-party payer settlements and adjustments to accruals recorded in prior years.

The following table represents the percentages of net revenue received from payers during the years ended September 30, 2013 and 2012:

	2013	2012
Medicare	36%	38%
Medicaid	7%	9%
Third parties	43%	39%
Other	14%	14%

Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 3 – NET REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE (CONTINUED)

The significant concentrations of net accounts receivable for services to patients by payer at September 30, 2013 and 2012 follow:

	2013	2012
Medicare	27%	26%
Medicaid	11%	10%
Third parties	44%	38%
Other	18%	26%

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 payers, have been settled by final settlement through 2010 for Medicare and 2007 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.

CHARITY CARE

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 poverty income levels for the State, but also includes certain cases where incurred charges are significant when compared to incomes. These charges are not included in net patient service revenues for financial reporting purposes.

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

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 3 – NET REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE (CONTINUED)

to certain patients that qualify under its charity care policy. For the years ended September 30, 2013 and 2012, the Hospital estimates that its costs of care provided under its charity care programs approximated \$134,000 and \$78,000, 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.

BAD DEBTS

The Hospital's estimation of the allowance for uncollectible accounts is based primarily upon the type and age of the patient accounts receivable and the effectiveness of the Hospital's collection efforts. The Hospital's policy is to reserve a portion of all self-pay receivables, including amounts due from the uninsured and amounts related to co-payments and deductibles, as these charges are recorded. On a monthly basis, the Hospital reviews its accounts receivable balances, the effectiveness of the Hospital's reserve policies and various analytics to support the basis for its estimates. These efforts primarily consist of reviewing the following:

- Revenue and volume trends by payer, particularly the self-pay components;
- Changes in the aging and payer mix of accounts receivable, including increased focus on accounts due from the uninsured and accounts that represent co-payments and deductibles due from patients;
- Various allowance coverage statistics.

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

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 3 – NET REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE (CONTINUED)

A summary of the Hospital's allowance for doubtful accounts activity for the years ended September 30, 2013 and 2012 is as follows:

	Balance at Beginning of Period	Additions Recorded in the Provision for Bad Debts	Accounts Written off, Net of Recoveries and Other	Balance at End of Period
Allowance for doubtful accounts:				
Year ended September 30, 2012	\$ (2,534,000)	\$ (3,773,454)	\$ 3,605,454	\$ (2,702,000)
Year ended September 30, 2013	\$ (2,702,000)	\$ (4,584,989)	\$ 3,561,989	\$ (3,725,000)

ICD-10 IMPLEMENTATION

The Hospital is subject to the administrative simplification provisions of HIPAA which require the use of uniform electronic data transmission standards for health care claims and payment transactions submitted or received electronically.

In January 2009, the Centers for Medicare and Medicaid Services (CMS) published its tenth revision of International Statistical Classification of Diseases and Related Health Problems (ICD-10) and related changes to the formats used for certain electronic transactions. ICD-10 contains significantly more diagnostic and procedural codes than the existing ICD-9 coding system, and as a result, the coding for the services provided in the Hospital and its clinics will require much greater specificity when ICD-10 becomes effective on October 1, 2014.

Implementation of ICD-10 will require a significant investment in technology and training. The Hospital may experience delays in reimbursement while the Hospital and the payers from which it seeks reimbursement make the transition to ICD-10. If the Hospital fails to implement the new coding system by the deadline, the Hospital will not be paid for services. Management is not able to reasonably estimate the overall financial impact of the Hospital's transition to ICD-10.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 4 – ASSETS WHOSE USE IS LIMITED

The composition of assets whose use is limited, which include beneficial interests in perpetual trusts, cash restricted for payment of workers compensation claims and investments permanently restricted by donors are set forth in the following table. Investments are stated at fair value.

	2013		2012	
	Cost	Fair Value	Cost	Fair Value
Cash and cash equivalents	\$ 1,136,345	\$ 1,136,345	\$ 1,206,684	\$ 1,206,684
Money market funds	20,460	20,460	858,411	858,411
Mutual funds - equity	560,817	577,579	94,306	102,080
Mutual funds - fixed	110,126	104,946	106,078	108,381
Collective funds - equity	70,415	80,670	40,979	71,167
Collective funds - fixed	332,391	401,844	32,941	34,524
Investment grade taxable bonds	33,233	31,947	744,647	859,176
Global high yield bonds	99,698	105,211	109,113	104,948
Equities				
U.S. large cap	807,823	894,907	836,560	886,042
U.S. mid cap	216,666	258,354	192,297	241,423
U.S. small cap	201,958	225,209	65,729	62,424
International developed	329,802	352,583	84,912	86,026
Real estate	199,572	188,086	61,886	70,285
Tangible assets - commodities	233,497	219,202	147,088	131,605
Emerging markets	260,180	244,309	--	--
	<u>\$ 4,612,983</u>	<u>\$ 4,841,652</u>	<u>\$ 4,581,631</u>	<u>\$ 4,823,176</u>

Investment income and losses on investments recorded in the consolidated statements of operations for the years ended September 30 are below.

	2013	2012
Income		
Interest and dividend income	\$ 198,178	\$ 215,020
Realized losses on sales of securities	--	(2,797)
	198,178	212,223
Less investment management fees	(39,378)	(35,217)
Net investment gains	<u>\$ 158,800</u>	<u>\$ 177,006</u>

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 5 – FAIR VALUE MEASUREMENTS

Assets and liabilities recorded at fair value in the financial statements are categorized, for disclosure purposes, based upon whether the inputs used to determine their fair values are observable or unobservable utilizing a three-level fair value hierarchy that prioritizes the inputs used to measure assets and liabilities 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 or liability.

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

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 were not available. The fair values of Level 3 securities were determined primarily through information obtained from the relevant counterparties for such investments, as information on which these securities' fair values are based is generally not readily available in the market.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 5 – FAIR VALUE MEASUREMENTS (CONTINUED)

The following table summarizes fair value measurements, by level, at September 30, 2013 and 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
September 30, 2013				
Beneficial interests in perpetual trusts				
Cash and cash equivalents	\$ 24,420	\$ --	\$ --	\$ 24,420
Money market funds	20,460	--	--	20,460
Mutual funds - equity	577,579	--	--	577,579
Mutual funds - fixed	104,946	--	--	104,946
Collective funds - equity	--	--	80,670	80,670
Collective funds - fixed	--	--	401,844	401,844
Investment grade				
taxable bonds	31,947	--	--	31,947
Global high yield bonds	105,211	--	--	105,211
Equities				
U.S. large cap	894,907	--	--	894,907
U.S. mid cap	258,354	--	--	258,354
U.S. small cap	225,209	--	--	225,209
International developed	352,583	--	--	352,583
Emerging markets	244,309	--	--	244,309
Real estate	188,086	--	--	188,086
Tangible assets-commodities	--	--	219,202	219,202
Total beneficial interests in perpetual trusts	3,028,011	--	701,716	3,729,727
Restricted cash and board designated investments				
investments	268,338	--	--	268,338
Investments permanently restricted by donor				
restricted by donor	843,587	--	--	843,587
	\$ 4,139,936	\$ --	\$ 701,716	\$ 4,841,652

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 5 – FAIR VALUE MEASUREMENTS (CONTINUED)

	Level 1	Level 2	Level 3	Total
September 30, 2012				
Beneficial interests in perpetual trusts				
Money market funds	\$ 858,411	\$ --	\$ --	\$ 858,411
Mutual funds - equity	102,080	--	--	102,080
Mutual funds - fixed	108,381	--	--	108,381
Collective funds - equity	--	--	71,167	71,167
Collective funds - fixed	--	--	34,524	34,524
Investment grade				
taxable bonds	859,176	--	--	859,176
Global high yield bonds	104,948	--	--	104,948
Equities				
U.S. large cap	886,042	--	--	886,042
U.S. mid cap	241,423	--	--	241,423
U.S. small cap	62,424	--	--	62,424
International developed	86,026	--	--	86,026
Real estate	70,285	--	--	70,285
Tangible assets-commodities	--	--	131,605	131,605
Total beneficial interests in perpetual trusts	3,379,196	--	237,296	3,616,492
Restricted cash and board designated investments				
	363,097	--	--	363,097
Investments permanently restricted by donor				
	843,587	--	--	843,587
	<u>\$ 4,585,880</u>	<u>\$ --</u>	<u>\$ 237,296</u>	<u>\$ 4,823,176</u>

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 5 – FAIR VALUE MEASUREMENTS (CONTINUED)

The following is a reconciliation of Level 3 assets for which significant unobservable inputs were used to determine fair value:

	<u>Beneficial Interests in Perpetual Trusts</u>
Balance at October 1, 2011	\$ 84,457
Purchases of investments	147,088
Changes in fair value	<u>5,751</u>
Balance at September 30, 2012	237,296
Purchases of investments	233,497
Changes in fair value	<u>230,923</u>
Balance at September 30, 2013	<u>\$ 701,716</u>

NOTE 6 – RESTRICTED ENDOWMENTS

The Hospital's endowments consist of donor-restricted endowment funds and beneficial interests in perpetual trusts. Net assets associated with endowment funds are classified and reported based on donor-imposed restrictions.

The Hospital's Board of Directors 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. This does not apply to beneficial interests in perpetual trusts where the fair value of the investments is the basis for the amount recorded as permanently restricted net assets.

As a result of the interpretation of UPMIFA, 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 unrestricted net assets based on the donors' stipulations and those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard for expenditures as proscribed by UPMIFA.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 6 – RESTRICTED ENDOWMENTS (CONTINUED)

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 endowment funds, the Hospital's Board of Directors 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 annually. Actual returns in any given year may vary from this amount.

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 to achieve its long-term return objectives within prudent risk constraints.

SPENDING POLICY AND HOW THE INVESTMENT OBJECTIVES RELATE TO THE 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 the trusts' market value that 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.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 6 – RESTRICTED ENDOWMENTS (CONTINUED)

ENDOWMENT NET ASSET COMPOSITION BY TYPE OF FUND AS OF SEPTEMBER 30, 2013 AND 2012:

	Unrestricted	Permanently Restricted	Total
September 30, 2013			
Donor-restricted endowment funds	\$ --	\$ 843,587	\$ 843,587
Beneficial interests in perpetual trusts	<u> --</u>	<u>3,729,727</u>	<u>3,729,727</u>
	<u>\$ --</u>	<u>\$ 4,573,314</u>	<u>\$ 4,573,314</u>

CHANGES IN ENDOWMENT NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

	Unrestricted	Permanently Restricted	Total
September 30, 2013			
Endowment net assets, beginning	<u>\$ --</u>	<u>\$ 4,460,079</u>	<u>\$ 4,460,079</u>
Investment return:			
Investment income	158,000	--	158,000
Net unrealized gains	<u> --</u>	<u>113,235</u>	<u>113,235</u>
Total investment return	<u>158,000</u>	<u>113,235</u>	<u>271,235</u>
Appropriation of endowment assets for expenditure	<u>(158,000)</u>	<u> --</u>	<u>(158,000)</u>
Endowment net assets, ending	<u>\$ --</u>	<u>\$ 4,573,314</u>	<u>\$ 4,573,314</u>

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 6 – RESTRICTED ENDOWMENTS (CONTINUED)

	Unrestricted	Permanently Restricted	Total
September 30, 2012			
Endowment net assets, beginning	\$ --	\$ 4,009,309	\$ 4,009,309
Investment return:			
Investment income	177,006	--	177,006
Net unrealized gains	--	450,770	450,770
Total investment return	177,006	450,770	627,776
Appropriation of endowment assets for expenditure	(177,006)	--	(177,006)
Endowment net assets, ending	\$ --	\$ 4,460,079	\$ 4,460,079

NOTE 7 – TEMPORARILY RESTRICTED AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets of \$268,927 and \$262,646 as of September 30, 2013 and 2012, respectively, consist of assets restricted to make capital purchases and restricted amounts received from various fundraising events.

Permanently restricted net assets of \$4,573,314 and \$4,460,079 at September 30, 2013 and 2012, respectively, represent assets to be held in perpetuity, the income from which is expendable to support health care services and the general operations of the Hospital.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 8 – PROPERTY, PLANT AND EQUIPMENT

The components of cost and the related accumulated depreciation comprising property, plant and equipment as of September 30, 2013 and 2012 are as follows:

	2013	2012
Land	\$ 406,997	\$ 406,997
Land improvements	1,558,879	1,558,879
Building and improvements	24,574,732	24,468,554
Fixed and movable equipment	<u>32,774,770</u>	<u>32,571,220</u>
	59,315,378	59,005,650
Less accumulated depreciation	<u>(42,249,206)</u>	<u>(39,398,697)</u>
	<u>\$ 17,066,172</u>	<u>\$ 19,606,953</u>

Depreciation expense for property, plant and equipment amounted to \$2,932,000 and \$3,029,561 for the years ended September 30, 2013 and 2012, respectively. Included within depreciation and amortization expense on the statements of operations is amortization for capital leased assets of \$14,170 and \$43,886 for the years ended September 30, 2013 and 2012, respectively (see Note 10).

NOTE 9 – DEBT

MORTGAGE NOTE PAYABLE

On August 1, 2006, the Hospital entered into a \$13,700,000 commercial construction mortgage loan with a bank. The loan was used to finance the expansion and renovation of the emergency department, three nursing units, the psychiatric unit, and two medical and surgical units, and to refinance the Hospital's existing loans (collectively, the Project). In December 2007, the loan was converted to a term loan, which is guaranteed by the United States Department of Agriculture (USDA) through the USDA Rural Development Community Facilities Program. The term loan calls for equal quarterly principal payments of \$85,625 over 40 years and will mature on January 1, 2048. Fifty percent of the loan bears interest at the bank's five year cost of borrowing plus 1.50% and fifty percent of the loan bears interest at the three month LIBOR plus 1.25%. The interest rates in effect at September 30, 2013 were 6.63% and 1.52%, respectively.

As of September 30, 2013, there was a principal balance of \$11,987,500 due on the mortgage.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 9 – DEBT (CONTINUED)

The Hospital is required to meet covenants under the mortgage. During the year ended September 30, 2013, the Hospital failed certain covenants and failed to make certain mortgage payments resulting in a delinquent balance of approximately \$645,000 at September 30, 2013. The bank has the right to demand immediate payment of the \$11,987,500 balance of the mortgage which has been classified as a current liability as of September 30, 2013. The net book value of the collateral for this mortgage was approximately \$16,800,000 as of September 30, 2013.

In 2006, the Hospital entered into a loan to finance certain information systems equipment at an interest rate of 5.5%. The Hospital failed to make payments in accordance with the loan terms. The Hospital's loan to refinance information equipment was restructured to be paid in 60 monthly installments of \$10,000. The present value of the settlement value of this loan was \$232,609 and \$332,047 at September 30, 2013 and 2012, respectively.

Future minimum payments by year and in the aggregate for the mortgage loan and subordinated debt were as follows at September 30, 2013:

2014	\$ 12,095,087
2015	<u>125,022</u>
	<u>\$ 12,220,109</u>

REVOLVING LOAN

In September 2010, the Hospital, along with several affiliates (the Borrowers), entered into a Revolving Loan and Security Agreement (senior debt under revolving line of credit) with a lender for an amount not to exceed the lesser of \$8 million or the maximum borrowing base (85% of the book value of all eligible receivables). Under the original agreement, amounts outstanding bear interest at the rate of the 3 month LIBOR rate plus 4.25% payable monthly in arrears. In the event of a default, the agreement provides for an increase in the interest rate by 4%. The Hospital has granted the lender a security interest in accounts receivable. On July 12, 2012, this agreement was amended as a result of the affiliation between the Johnson Entities and Saint Francis to extend the line of credit expiration date to September 27, 2014, however, as a result of covenant defaults in 2013, the lender can call the debt on demand after September 30, 2013.

The Hospital is jointly and severally liable for the full payment of the debt under this agreement, including any debt incurred by Evergreen and Home & Community Health Services, Inc.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 9 – DEBT (CONTINUED)

As of September 30, 2013, there were outstanding borrowings of \$2,208,858 under the Loan and Security Agreement. As a result of the default, the lender has no obligation to provide additional loans to the Hospital.

The Borrowers are subject to a number of covenants and restrictions under the Revolving Loan and Security Agreement. These include the following affirmative and negative covenants: provision of monthly, quarterly and annual financial information, adequate insurance coverage, notice of certain events and changes, change in ownership or management, restrictions on indebtedness and lease agreements, sale of assets, protection of collateral and financial covenants prepared on a consolidated basis for the Borrowers including cash flow and debt service coverage ratio requirements.

During 2013, the Borrowers failed to comply with various covenants under the Revolving Loan and Security Agreement which resulted in the lender imposing an interest penalty. The Borrowers received forbearance by the lender from imposing certain rights as a result of these defaults until September 30, 2013. Subsequent to September 30, 2013, the lender has the ability to demand repayment of the loan.

OTHER DEBT

The other long-term debt of \$2,350,000 and \$1,300,000 as of September 30, 2013 and 2012, respectively, and \$350,000 of other current debt at September 30, 2013 represents the amounts owed to Saint Francis under the terms of the affiliation agreement. Reference is made to Note 1. Effective October 1, 2013, \$350,000 of the debt becomes subject to interest at the prime rate plus 2%. The remaining balance of this debt is not subject to interest.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 10 – LEASE OBLIGATIONS

CAPITAL LEASES

The Hospital has entered into non-cancelable capital lease obligations for certain equipment. The cost of the assets is being amortized over the useful lives of the assets or the shorter of the respective lease term or useful life if the asset does not transfer to the Hospital at the end of the lease term and is summarized as of September 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Medical and other equipment	\$ 70,850	\$ 497,904
Less, accumulated amortization	<u>(15,351)</u>	<u>(129,296)</u>
	<u>\$ 55,499</u>	<u>\$ 368,608</u>

On June 27, 2013, the Hospital entered into a five year capital lease agreement to lease generators with a cost of \$688,000. The monthly lease payments will total \$10,500 for the first year and \$15,400 for the remainder of the lease term with total payments of \$865,296. The generators were not received as of September 30, 2013, therefore, the lease is not recorded in the Hospital's balance sheet.

Future minimum lease payments under the capital leases (excluding the aforementioned generator lease), together with the present value of future minimum lease payments, as of September 30, 2013 are as follows:

2014	\$ 19,681
2015	18,108
2016	18,108
2017	<u>16,599</u>
Total future minimum lease payments	72,496
Less, amounts representing interest	<u>12,552</u>
Present value of future minimum lease payments	59,944
Less current portion	<u>14,365</u>
	<u>\$ 45,579</u>

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 10 – LEASE OBLIGATIONS (CONTINUED)

OPERATING LEASES

The Hospital leases various computer equipment, medical equipment and office space under operating leases, which expire at various dates through 2015. Rent expense under the operating leases was \$2,223,374 and \$2,268,594 in 2013 and 2012, respectively. These leases have various terms and conditions. The Hospital subleases land to an affiliated corporation under a month-to-month lease arrangement. Sublease income was \$180,000 for each of the fiscal years ended September 30, 2013 and 2012.

Minimum future rental commitments on these non-cancelable operating leases with initial or remaining terms of more than one year as of September 30, 2013 are as follows:

2014	\$	434,628
2015		<u>196,591</u>
	\$	<u>631,219</u>

NOTE 11 – EMPLOYEE BENEFIT PLANS

The Hospital formerly had a defined benefit pension plan that covered certain employees. Pursuant to the plan of reorganization, the Pension Benefit Guaranty Corporation assumed control of the defined benefit plan effective September 1, 2011.

The Hospital has a defined contribution plan (the Plan) whereby all employees who have attained the age of 21 and completed one year of employment (1,000 hours of service) are eligible to participate and become fully vested after 5 years. Annually, the Hospital may contribute a defined amount of employees' salaries to the Plan. Effective January 1, 2011, the Hospital suspended the matching of non-union employee contributions; it continued to pay the match on union employees up until June 2012, at which time only those union employees that had been grandfathered in the Plan were matched. The total expense incurred by the Hospital for contributions was \$147,244 in 2013. The total expense incurred by the Hospital for contributions made to the Plan was \$249,482 in 2012. It is uncertain whether this match will be reinstated.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 12 – SELF-INSURANCE CLAIMS

There have been medical malpractice and workers' compensation claims that have been asserted against the Hospital. In addition, there are known incidents that have occurred through September 30, 2013 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.

NOTE 13 – PROFESSIONAL, GENERAL LIABILITY AND WORKERS' COMPENSATION INSURANCE

For claims incurred through August 31, 2009, the Hospital was self-insured for professional liability and general liability claims, under a claims made policy, which covered the Corporation's entire health system. The Corporation has an excess umbrella claims made policy for claims in excess of the Corporation's self-insured limits.

For claims incurred after August 31, 2009, the Hospital was covered under commercial claims made policies with no deductible and coverage of \$1,000,000 per claim and an annual aggregate of \$3,000,000 for all of the entities covered under the policy.

The Corporation's independent actuary estimated the expected costs to settle claims incurred during the self-insured period and claims that were incurred but not reported (IBNR) under its claims made insurance policy. Accrued losses have been discounted at 3%. The Hospital has accrued liabilities of \$641,424 and \$1,090,230 for the estimated claims that have been incurred but not reported and cases incurred during the self-insured period for its professional liability and general liability insurance risks as of September 30, 2013 and 2012, respectively.

The Hospital was also self-insured for workers compensation claims through March 16, 2009 at which time it obtained commercial insurance. The Hospital's workers' compensation policy has no deductible and policy limits of \$1,000,000 per case with no aggregate limit for claims incurred after March 16, 2009.

In accordance with the provisions of ASU 2010-24, the Hospital recorded recoverables from insurance companies for the estimated costs to settle fully insured malpractice and workers' compensation claims in the amounts of \$438,332 and \$561,508 as of September 30, 2013 and 2012, respectively. The Hospital has recorded liabilities equal to these amounts as of September 30, 2013 and 2012.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 14 – COMMITMENTS AND CONTINGENCIES

The Hospital is a party to various lawsuits incidental to its business.

The Hospital also has the following environmental exposures:

The Connecticut Department of Public Health (DPH) issued an order that requires the Hospital to monitor drinking water that comes from its well field, report the results and submit plans for review and approval by DPH to upgrade the drinking water supply system to reduce the level of uranium found in the well water. The Hospital and DPH agreed on plans and specifications for the Hospital to construct improvements to the well system and report to DPH that the work has been completed. The Hospital completed the construction of the well system improvements at a cost of \$321,292 and DPH acknowledged the project completion in a letter to the hospital dated June 26, 2012.

The Connecticut Department of Environmental Protection (DEP) issued a consent order (Sewer Order) which requires the Hospital to perform repairs or replacements to the aging wastewater treatment system at the Hospital. The Sewer Order requires a short-term and a long-term solution. The short-term work has been completed in accordance with the Sewer Order and the Hospital has been reporting to the DEP on the status of the short-term solution. Under the long-term solution, the Hospital had until March 30, 2011 to submit to the DEP for review and approval a schedule for: (i) the investigation of and remedial action alternatives to abate any pollution at the site arising from the operation of the on-site sewage treatment system or (ii) the construction of sanitary sewers to connect the Hospital to the Stafford Water Pollution Control Facility. The schedule shall provide for completion of the actions not later than December 31, 2014. The Hospital has designed and engineered a solution that is expected to be acceptable to the DEP. This solution is expected to cost approximately \$855,000. As of September 30, 2013, funds to finance the project had not been secured.

The DEP filed a civil suit in 2007 in which the DEP sought civil penalties and temporary and permanent injunctions prohibiting the Hospital from violating the hazardous waste management regulations, preventing the Hospital from maintaining a discharge to the waters of the state and violating its air permit. Five of the six counts arose from allegations relating to the use of an underground storage tank for the storage of x-ray developer fixer and the release of the developer fixer from the tank. Use of that tank ended in April 2004 and the tank was removed. Part of the injunctive relief sought is an order requiring the investigation and remediation of the release of x-ray development fixer. The sixth count alleged that the Hospital violated its general air permit by submitting its annual compliance certification for 2005 ten months late. The Hospital has recorded a conditional retirement obligation related to the costs of an environmental investigation, but has not recorded a liability for any potential costs to remediate the site due to the fact that such costs, if any, cannot be reasonably estimated until the investigation is performed. The Hospital previously

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 14 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

remediated the site when the tank was originally removed. The Hospital and the DEP have come to agreement as to a stipulation for judgment resolving the case in which the Hospital agree to: (1) the payment of a civil penalty from the bankruptcy estate (thus having no effect on the Hospital); (2) submit a groundwater monitoring plan which is to determine the sufficiency of the remedial actions taken in 2007 with respect to the removal of the old x-ray developer tank; (3) undertake waste determinations as required by state and federal regulations for all waste generated at the Hospital; and (4) file all annual reports with respect to the general air permit on time in the future.

NOTE 15 – TRANSACTIONS WITH AFFILIATES

During 2013 and 2012, the Hospital billed affiliated organizations \$662,160 for both years for certain expenses and rental of space.

The amounts due from (to) affiliates represent receivables from and (payables) to affiliates that do not eliminate in consolidation. These balances are comprised of the following at September 30:

	2013	2012
Due to Johnson Memorial Corporation	\$ (2,263,802)	\$ (1,779,380)
Due to Home and Community Health Services, Inc.	(70,249)	(217,177)
Due from Johnson Evergreen Corporation	79,991	243,340
Due to Johnson Health Care, Inc.	<u>(63,281)</u>	<u>(63,951)</u>
	<u>\$ (2,317,342)</u>	<u>\$ (1,817,168)</u>

During the year ended September 30, 2012, Johnson Medical Specialists, P.C. transferred net assets of \$74,638 to JPA.

The Hospital has provided guarantees of the debt of the Corporation and Evergreen which had balances of \$3,001,081 and \$14,213,697, respectively, as of September 30, 2013. During the year ended September 30, 2013, the Corporation and Evergreen failed to make certain payments due under the terms of these debt agreements and failed other covenants. The bank has the ability to demand repayment of the debt from the Hospital in accordance with the terms of the guarantee.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

NOTE 16 – CONCENTRATIONS OF CREDIT RISK

The Hospital's financial instruments that are exposed to concentrations of credit risk consist primarily of cash, investments and accounts receivable.

The Hospital places its cash deposits with high credit-quality institutions, which, at times, may exceed the Federal Deposit Insurance Corporation limits of \$250,000 per bank. The Hospital has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

NOTE 17 – FUNCTIONAL EXPENSES

The Hospital provides general patient care services to residents within its geographic location. Expenses related to providing these services are as follows for the years ended September 30:

	<u>2013</u>	<u>2012</u>
Patient care services	\$ 58,180,001	\$ 55,467,851
General and administrative (including depreciation and amortization, interest and operations)	<u>10,932,726</u>	<u>12,837,401</u>
	<u>\$ 69,112,727</u>	<u>\$ 68,305,252</u>



**INDEPENDENT AUDITORS' REPORT
ON SUPPLEMENTARY INFORMATION**

Board of Directors
Johnson Memorial Hospital

We have audited the consolidated financial statements of Johnson Memorial Hospital as of and for the years ended September 30, 2013 and 2012, and our report thereon dated January 17, 2014, which contained a going concern opinion on those consolidated financial statements, appears on page 1. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information is presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Marcum LLP

Hartford, CT
January 17, 2014



JOHNSON MEMORIAL HOSPITAL

CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2013

	Hospital	JPA	Development	Elimination	Total
Assets					
Current Assets					
Cash and cash equivalents	\$ 188,181	\$ 5,860	\$ 16,111	\$ --	\$ 210,152
Patients accounts receivable, net of allowances for uncollectible accounts	7,312,397	319,712	--	--	7,632,109
Other receivables	1,688,323	2,905	--	--	1,691,228
Inventories	1,317,470	--	--	--	1,317,470
Prepaid expenses and other current assets	851,435	47,972	--	--	899,407
Total Current Assets	<u>11,357,806</u>	<u>376,449</u>	<u>16,111</u>	<u>--</u>	<u>11,750,366</u>
Assets Whose Use is Limited					
Beneficial interests in perpetual trusts	3,729,727	--	--	--	3,729,727
Restricted cash and board designated investments	268,338	--	--	--	268,338
Investments permanently restricted by donor	843,587	--	--	--	843,587
Total Assets Whose Use is Limited	<u>4,841,652</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>4,841,652</u>
Other Assets					
Property, plant and equipment, net	16,922,312	143,860	--	--	17,066,172
Investment in joint ventures	3,165,915	--	--	--	3,165,915
Due from affiliated corporations	5,093,786	--	--	(5,093,786)	--
Deferred financing costs, net	172,864	--	--	--	172,864
Other noncurrent assets	476,000	--	--	--	476,000
Total Other Assets	<u>25,830,877</u>	<u>143,860</u>	<u>--</u>	<u>(5,093,786)</u>	<u>20,880,951</u>
	<u>\$ 42,030,335</u>	<u>\$ 520,309</u>	<u>\$ 16,111</u>	<u>\$ (5,093,786)</u>	<u>\$ 37,472,969</u>

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2013

	Hospital	JPA	Development	Elimination	Total
Liabilities and Net Assets (Deficit)					
Current Liabilities					
Trade accounts payable	\$ 4,873,903	\$ 315,693	\$ --	\$ --	\$ 5,189,596
Accrued payroll and related costs	1,930,115	118,781	--	--	2,048,896
Current portion of payments due under plan of reorganization	1,947,500	--	--	--	1,947,500
Revolving line of credit	2,208,858	--	--	--	2,208,858
Current portion of mortgage payable	11,987,500	--	--	--	11,987,500
Current portion of subordinated and other debt	457,587	--	--	--	457,587
Current portion of capital lease obligations	14,365	--	--	--	14,365
Estimated amounts due to third-party agencies	2,564,571	--	--	--	2,564,571
Other current liabilities	<u>168,332</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>168,332</u>
Total Current Liabilities	<u>26,152,731</u>	<u>434,474</u>	<u>--</u>	<u>--</u>	<u>26,587,205</u>
Long-Term Obligations					
Due to affiliate corporations	1,268,030	14,112,083	--	(13,062,771)	2,317,342
Payments due under plan of reorganization - less current portion	3,930,808	--	--	--	3,930,808
Mortgage payable - less current portion	--	--	--	--	--
Subordinated debt - less current portion	125,022	--	--	--	125,022
Other long-term debt	2,350,000	--	--	--	2,350,000
Obligations under capital lease - less current portion	45,579	--	--	--	45,579
Self-insurance liabilities and IBNR	641,424	--	--	--	641,424
Other liabilities	<u>604,927</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>604,927</u>
Total Long-Term Obligations	<u>8,965,790</u>	<u>14,112,083</u>	<u>--</u>	<u>(13,062,771)</u>	<u>10,015,102</u>
Total Liabilities	<u>35,118,521</u>	<u>14,546,557</u>	<u>--</u>	<u>(13,062,771)</u>	<u>36,602,307</u>

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2013

	Hospital	JPA	Development	Elimination	Total
Net Assets (Deficit)					
Unrestricted	\$ 2,069,573	\$ (14,026,248)	16,111	\$ 7,968,985	\$ (3,971,579)
Temporarily restricted	268,927	--	--	--	268,927
Permanently restricted	<u>4,573,314</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>4,573,314</u>
Total Net Assets (Deficit)	<u>6,911,814</u>	<u>(14,026,248)</u>	<u>16,111</u>	<u>7,968,985</u>	<u>870,662</u>
	<u>\$ 42,030,335</u>	<u>\$ 520,309</u>	<u>\$ 16,111</u>	<u>\$ (5,093,786)</u>	<u>\$ 37,472,969</u>

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2012

	Hospital	JPA	Development	Elimination	Total
Assets					
Current Assets					
Cash and cash equivalents	\$ 787,925	\$ 3,825	\$ 27,577	\$ --	\$ 819,327
Patients accounts receivable, net of allowances for uncollectible accounts	8,023,775	380,008	--	--	8,403,783
Other receivables	193,008	29,521	--	--	222,529
Inventories	1,254,591	--	--	--	1,254,591
Prepaid expenses and other current assets	<u>759,969</u>	<u>93,093</u>	<u>--</u>	<u>--</u>	<u>853,062</u>
Total Current Assets	<u>11,019,268</u>	<u>506,447</u>	<u>27,577</u>	<u>--</u>	<u>11,553,292</u>
Assets Whose Use is Limited					
Beneficial interests in perpetual trusts	3,616,492	--	--	--	3,616,492
Restricted cash and board designated investments	363,097	--	--	--	363,097
Investments permanently restricted by donor	<u>843,587</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>843,587</u>
Total Assets Whose Use is Limited	<u>4,823,176</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>4,823,176</u>
Other Assets					
Property, plant and equipment, net	19,431,008	175,945	--	--	19,606,953
Investment in joint ventures	3,106,905	--	--	--	3,106,905
Due from affiliated corporations	3,858,694	--	--	(3,858,694)	--
Deferred financing costs, net	356,845	--	--	--	356,845
Other noncurrent assets	<u>445,000</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>445,000</u>
Total Other Assets	<u>27,198,452</u>	<u>175,945</u>	<u>--</u>	<u>(3,858,694)</u>	<u>23,515,703</u>
	<u>\$ 43,040,896</u>	<u>\$ 682,392</u>	<u>\$ 27,577</u>	<u>\$ (3,858,694)</u>	<u>\$ 39,892,171</u>

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATING BALANCE SHEET (CONTINUED)

SEPTEMBER 30, 2012

	Hospital	JPA	Development	Elimination	Total
Liabilities and Net Assets (Deficit)					
Current Liabilities					
Trade accounts payable	\$ 3,182,062	\$ 218,491	\$ --	\$ --	\$ 3,400,553
Accrued payroll and related costs	2,014,282	158,629	--	--	2,172,911
Current portion of payments due under plan of reorganization	997,500	--	--	--	997,500
Revolving line of credit	3,504,213	--	--	--	3,504,213
Current portion of mortgage payable	342,500	--	--	--	342,500
Current portion of subordinated and other debt	100,583	--	--	--	100,583
Current portion of capital lease obligations	61,820	--	--	--	61,820
Estimated amounts due to third-party agencies	1,272,580	--	--	--	1,272,580
Other current liabilities	116,508	--	--	--	116,508
Total Current Liabilities	<u>11,592,048</u>	<u>377,120</u>	<u>--</u>	<u>--</u>	<u>11,969,168</u>
Long-Term Obligations					
Due to affiliate corporations	942,068	12,702,779	--	(11,827,679)	1,817,168
Payments due under plan of reorganization - less current portion	5,505,445	--	--	--	5,505,445
Mortgage payable - less current portion	11,816,250	--	--	--	11,816,250
Subordinated debt - less current portion	231,464	--	--	--	231,464
Other long-term debt	1,300,000	--	--	--	1,300,000
Obligations under capital lease - less current portion	58,370	--	--	--	58,370
Self-insurance liabilities and IBNR	1,141,100	--	--	--	1,141,100
Other liabilities	769,553	--	--	--	769,553
Total Long-Term Obligations	<u>21,764,250</u>	<u>12,702,779</u>	<u>--</u>	<u>(11,827,679)</u>	<u>22,639,350</u>
Total Liabilities	<u>33,356,298</u>	<u>13,079,899</u>	<u>--</u>	<u>(11,827,679)</u>	<u>34,608,518</u>

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATING BALANCE SHEET (CONTINUED)

SEPTEMBER 30, 2012

	Hospital	JPA	Development	Elimination	Total
Net Assets (Deficit)					
Unrestricted	\$ 4,961,873	\$ (12,397,507)	\$ 27,577	\$ 7,968,985	\$ 560,928
Temporarily restricted	262,646	--	--	--	262,646
Permanently restricted	<u>4,460,079</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>4,460,079</u>
Total Net Assets (Deficit)	<u>9,684,598</u>	<u>(12,397,507)</u>	<u>27,577</u>	<u>7,968,985</u>	<u>5,283,653</u>
	<u>\$ 43,040,896</u>	<u>\$ 682,392</u>	<u>\$ 27,577</u>	<u>\$ (3,858,694)</u>	<u>\$ 39,892,171</u>

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Hospital	JPA	Development	Elimination	Total
Operating Revenue					
Net patient service revenues	\$ 64,089,036	\$ 3,986,146	\$ --	\$ --	\$ 68,075,182
Provision for uncollectible accounts	<u>4,455,452</u>	<u>129,537</u>	<u>--</u>	<u>--</u>	<u>4,584,989</u>
Net patient service revenue less provision for bad debts	59,633,584	3,856,609	--	--	63,490,193
Grant and other income	275,135	449,053	--	(399,728)	324,460
Net assets released from restriction	<u>443,523</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>443,523</u>
Total Operating Revenues	<u>60,352,242</u>	<u>4,305,662</u>	<u>--</u>	<u>(399,728)</u>	<u>64,258,176</u>
Expenses					
Salaries	26,864,410	2,743,273	--	773,971	30,381,654
Employee benefits	6,251,065	395,822	--	159,631	6,806,518
Professional fees and outsourced staffing	3,839,636	779,046	--	(70,491)	4,548,191
Depreciation and amortization	3,082,027	33,954	--	--	3,115,981
Purchased services	3,991,908	1,154,759	--	(1,243,992)	3,902,675
Supplies, drugs and patient care	8,594,710	109,625	--	--	8,704,335
Leases and service contracts	1,551,341	30,854	--	(18,847)	1,563,348
Occupancy costs	3,125,850	293,472	--	--	3,419,322
Insurance	818,443	273,615	--	--	1,092,058
Other expenses	4,090,417	119,983	--	--	4,210,400
Interest	<u>1,368,245</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>1,368,245</u>
Total Expenses	<u>63,578,052</u>	<u>5,934,403</u>	<u>--</u>	<u>(399,728)</u>	<u>69,112,727</u>
Loss from Operations	<u>(3,225,810)</u>	<u>(1,628,741)</u>	<u>--</u>	<u>--</u>	<u>(4,854,551)</u>

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Hospital	JPA	Development	Elimination	Total
Nonoperating Revenue					
Investment income	\$ 158,800	\$ --	\$ --	\$ --	\$ 158,800
Gain on sale of equipment	1,200	--	--	--	1,200
Equity earnings in joint ventures	<u>72,279</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>72,279</u>
	<u>232,279</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>232,279</u>
Deficiency of Revenues over Expenses	<u>\$ (2,993,531)</u>	<u>\$ (1,628,741)</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ (4,622,272)</u>

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE YEAR ENDED SEPTEMBER 30, 2012

	Hospital	JPA	Development	Elimination	Total
Operating Revenue					
Net patient service revenues	\$ 65,318,418	\$ 4,016,223	\$ --	\$ --	\$ 69,334,641
Provision for bad debts	<u>3,564,251</u>	<u>209,203</u>	<u>--</u>	<u>--</u>	<u>3,773,454</u>
Net patient service revenue less provision for bad debts	61,754,167	3,807,020	--	--	65,561,187
Grant and other income	257,382	930,057	--	(878,768)	308,671
Net assets released from restriction	<u>25,552</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>25,552</u>
Total Operating Revenues	<u>62,037,101</u>	<u>4,737,077</u>	<u>--</u>	<u>(878,768)</u>	<u>65,895,410</u>
Expenses					
Salaries	27,169,377	3,680,362	--	583,431	31,433,170
Employee benefits	6,788,404	453,433	--	128,353	7,370,190
Professional fees and outsourced staffing	2,874,357	555,730	--	(64,242)	3,365,845
Depreciation and amortization	3,178,071	35,471	--	--	3,213,542
Purchased services	4,029,151	1,128,581	--	(1,526,310)	3,631,422
Supplies, drugs and patient care	7,042,738	87,983	--	--	7,130,721
Leases and service contracts	1,651,342	26,374	--	--	1,677,716
Occupancy costs	2,820,491	291,194	--	--	3,111,685
Insurance	894,280	284,235	--	--	1,178,515
Other expenses	4,472,883	223,848	--	--	4,696,731
Interest	<u>1,495,715</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>1,495,715</u>
Total Expenses	<u>62,416,809</u>	<u>6,767,211</u>	<u>--</u>	<u>(878,768)</u>	<u>68,305,252</u>
Loss from Operations	<u>(379,708)</u>	<u>(2,030,134)</u>	<u>--</u>	<u>--</u>	<u>(2,409,842)</u>

JOHNSON MEMORIAL HOSPITAL
CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE YEAR ENDED SEPTEMBER 30, 2012

	Hospital	JPA	Development	Elimination	Total
Nonoperating Revenue					
Investment income	\$ 177,006	\$ --	\$ --	\$ --	\$ 177,006
Gain on sale of equipment	3,196	--	--	--	3,196
Equity loss in joint ventures	<u>250,254</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>250,254</u>
	<u>430,456</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>430,456</u>
Excess (Deficiency) of Revenues over Expenses	<u>\$ 50,748</u>	<u>\$ (2,030,134)</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ (1,979,386)</u>