

CONSOLIDATED FINANCIAL STATEMENTS

The New Milford Hospital, Incorporated and Subsidiary
Years Ended September 30, 2013 and 2012
With Report of Independent Auditors

Ernst & Young LLP



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The New Milford Hospital, Incorporated and Subsidiary

Consolidated Financial Statements

Years Ended September 30, 2013 and 2012

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Report of Independent Auditors

Board of Directors
The New Milford Hospital, Incorporated and Subsidiary

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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



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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The New Milford Hospital, Incorporated and Subsidiary at September 30, 2013 and 2012, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

January 21, 2014

The New Milford Hospital, Incorporated and Subsidiary

Consolidated Balance Sheets

	September 30	
	2013	2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,221,385	\$ 6,281,016
Accounts receivable, less allowance for uncollectible accounts of approximately \$1,893,000 in 2013 and \$2,387,000 in 2012	7,314,799	8,601,320
Current portion of assets limited as to use	—	1,200,000
Current portion of pledges receivable	—	900,631
Inventories	1,521,171	1,645,080
Prepaid expenses and other	371,475	900,544
Total current assets	<u>11,428,830</u>	<u>19,528,591</u>
Investments	—	2,706,138
Assets limited as to use:		
Funds restricted by donor	—	421,160
Beneficial interest in trusts held by others	—	4,134,546
Total noncurrent assets limited as to use	<u>—</u>	<u>4,555,706</u>
Other assets	4,652,903	4,541,461
Interest in Western Connecticut Health Network Foundation, Inc.	11,319,493	—
Property, plant, and equipment:		
Land and land improvements	1,461,567	1,544,196
Buildings and building improvements	47,784,373	49,484,944
Equipment and other	43,953,291	56,864,547
Construction in progress (estimated cost to complete at September 30, 2013: \$10,650,000)	4,537,992	298,414
	<u>97,737,223</u>	<u>108,192,101</u>
Less accumulated depreciation	63,868,519	75,751,426
	<u>33,868,704</u>	<u>32,440,675</u>
Pledges receivable, less current portion	—	2,602,193
Total assets	<u>\$ 61,269,930</u>	<u>\$ 66,374,764</u>

	September 30	
	2013	2012
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 2,545,429	\$ 3,081,591
Payroll-related accruals	2,391,153	3,202,850
Due to third-party payors	1,973,652	2,461,714
Current portion of due to related parties	6,514,591	5,057,706
Other accrued expenses	358,515	460,952
Current portion of long-term debt and capital lease obligations	—	495,090
Total current liabilities	<u>13,783,340</u>	<u>14,759,903</u>
Accrued pension liabilities and other	13,282,674	26,239,675
Due to related parties, less current portion	2,476,284	3,815,518
Long-term debt and capital lease obligations, less current portion	—	1,013,765
Total liabilities	<u>29,542,298</u>	<u>45,828,861</u>
Net assets:		
Unrestricted	23,332,942	12,487,373
Temporarily restricted	4,125,215	3,923,984
Permanently restricted	4,269,475	4,134,546
Total net assets	<u>31,727,632</u>	<u>20,545,903</u>

Total liabilities and net assets

\$ 61,269,930 \$ 66,374,764

See accompanying notes.

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

	Year Ended September 30	
	2013	2012
Unrestricted revenues:		
Net patient service revenue	\$ 72,281,954	\$ 81,236,073
Provision for bad debt	2,560,334	3,125,172
Net patient service revenue less provision for bad debt	<u>69,721,620</u>	<u>78,110,901</u>
Net assets released from restriction	130,298	66,843
Other operating revenue	744,102	1,034,489
	<u>70,596,020</u>	<u>79,212,233</u>
Expenses:		
Salaries, benefits and fees	44,019,423	51,817,496
Supplies and other	21,170,383	25,778,114
Insurance	2,065,741	1,643,424
Depreciation and amortization	5,443,180	5,526,925
Interest	263,572	419,014
	<u>72,962,299</u>	<u>85,184,973</u>
Loss from operations	<u>(2,366,279)</u>	<u>(5,972,740)</u>
Nonoperating income (loss):		
Contributions	–	1,009,077
Investment income, net	–	429,853
Change in unrealized gains and losses on investments	–	(12,206)
Operating expenses of the New Milford Hospital Foundation, Inc.	–	(654,269)
Change in equity interest in unrestricted net assets of the Western Connecticut Health Network Foundation, Inc.	282,759	–
	<u>282,759</u>	<u>772,455</u>
Deficiency of revenues over expenses	<u>(2,083,520)</u>	<u>(5,200,285)</u>

Continued on next page.

The New Milford Hospital, Incorporated and Subsidiary

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

	Year Ended September 30	
	2013	2012
Unrestricted net assets:		
Deficiency of revenues over expenses (continued)	\$ (2,083,520)	\$ (5,200,285)
Change in equity interest of the Western Connecticut Health Network Foundation, Inc.	2,642,044	-
Net assets released from restrictions for property, plant and equipment	1,107,256	207,624
Transfers from temporarily restricted net assets	-	16,879
Change in pension funding obligation	11,821,833	(7,274,255)
Acquisition of non-controlling interest in joint venture	-	(1,176,149)
Transfer from (to) Western Connecticut Health Network Foundation, Inc.	4,010,000	(16,879)
Transfer to Western Connecticut Health Network, Inc.	(6,652,044)	-
Other	-	(245,954)
Increase (decrease) in unrestricted net assets	<u>10,845,569</u>	<u>(13,689,019)</u>
Temporarily restricted net assets:		
Contributions	-	3,689,567
Net assets released from restriction	(130,298)	(66,843)
Net assets released from restrictions for property, plant and equipment	(1,107,256)	(207,624)
Transfer to unrestricted net assets	-	(16,879)
Change in equity interest of the Western Connecticut Health Network Foundation, Inc.	4,125,215	-
Transfer from Western Connecticut Health Network Foundation, Inc.	1,237,554	-
Transfer to Western Connecticut Health Network, Inc.	(3,923,984)	-
Increase in temporarily restricted net assets	<u>201,231</u>	<u>3,398,221</u>
Permanently restricted net assets:		
Change in equity interest of the Western Connecticut Health Network Foundation, Inc.	4,269,475	-
Transfer to Western Connecticut Health Network, Inc.	(4,134,546)	-
Increase in beneficial interest in trusts held by others	-	447,705
Increase in permanently restricted net assets	<u>134,929</u>	<u>447,705</u>
Increase (decrease) in net assets	<u>11,181,729</u>	<u>(9,843,093)</u>
Net assets at beginning of year	<u>20,545,903</u>	<u>30,388,996</u>
Net assets at end of year	<u>\$ 31,727,632</u>	<u>\$ 20,545,903</u>

See accompanying notes.

The New Milford Hospital, Incorporated and Subsidiary

Consolidated Statements of Cash Flows

	Year Ended September 30	
	2013	2012
Operating activities		
Increase (decrease) in net assets	\$ 11,181,729	\$ (9,843,093)
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities:		
Depreciation and amortization	5,443,180	5,526,925
Change in unrealized gains and losses on investments	—	12,206
Change in equity interest of the Western Connecticut Health Network Foundation, Inc.	(11,319,493)	—
Transfer from Western Connecticut Health Network Foundation, Inc.	(5,247,554)	—
Transfer to Western Connecticut Health Network, Inc.	14,710,574	—
Change in pension funding obligation	(11,821,833)	7,274,255
Restricted contributions and investment income	—	(3,689,567)
Change in beneficial interest in trusts held by others	—	(447,705)
Provision for bad debt	2,560,334	3,125,172
Change in other	—	245,954
Changes in operating assets and liabilities <i>(see Note 11)</i>	(3,988,441)	(8,187,745)
Net cash used in operating activities	<u>1,518,496</u>	<u>(5,983,598)</u>
Investing activities		
Additions to property, plant, and equipment, net	(6,871,209)	(3,222,569)
Change in due to related parties	117,651	(358,093)
Increase in investments, net and assets limited as to use	—	(103,741)
Net cash used in investing activities	<u>(6,753,558)</u>	<u>(3,684,403)</u>
Financing activities		
Payments of long-term debt and capital lease obligations	(1,508,855)	(415,636)
Transfer from Western Connecticut Health Network Foundation, Inc.	5,247,554	—
Transfer to Western Connecticut Health Network, Inc.	(2,563,268)	—
Restricted contributions and investment income	—	3,689,567
Net cash provided by financing activities	<u>1,175,431</u>	<u>3,273,931</u>
Net decrease in cash and cash equivalents	<u>(4,059,631)</u>	<u>(6,394,070)</u>
Cash and cash equivalents at beginning of year	6,281,016	12,675,086
Cash and cash equivalents at end of year	<u>\$ 2,221,385</u>	<u>\$ 6,281,016</u>

On October 1, 2012 the Foundation's assets were transferred to Western Connecticut Health Network, Inc. Refer to Note 1.

See accompanying notes.

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements

September 30, 2013

1. Summary of Significant Accounting Policies

Organization and Basis of Presentation

The New Milford Hospital, Incorporated (the New Milford Hospital) is a voluntary, not-for-profit, non-stock corporation incorporated under the General Statutes of the State of Connecticut and is the sole corporate member of its subsidiary, New Milford Hospital Foundation, Inc. (collectively, the Hospital). The Hospital is a member of Western Connecticut Health Network, Inc. (WCHN). This affiliation allows the Hospital to retain separate licenses and operate autonomously, while promoting collaboration and efficiencies to provide innovative and accessible quality health care for residents of western Connecticut and adjacent eastern New York.

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

On October 1, 2012 the Foundation's assets were transferred to WCHN, which then transferred the assets to Western Connecticut Health Network Foundation, Inc., also a subsidiary of WCHN:

Cash and cash equivalents	\$ 2,563,268
Land held for investment	1,200,000
Pledges receivable	3,502,824
Investments	2,706,138
Funds restricted by donor	421,160
Beneficial interest in trusts held by others	4,134,546
Other assets	182,638
	<u>\$ 14,710,574</u>

The transfer comprised the following:

Unrestricted net assets	\$ 6,652,044
Temporarily restricted net assets	3,923,984
Permanently restricted net assets	4,134,546
	<u>\$ 14,710,574</u>

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

1. Summary of Significant Accounting Policies (continued)

The accompanying consolidated financial statements for the year ended September 30, 2012 includes the accounts of the New Milford Hospital and the Foundation. All material intercompany accounts and transactions have been eliminated in consolidation.

Effective October 28, 2009, the New Milford Hospital formed a strategic partnership with Radcorp of New Milford, LLC. The partnership, New Milford MRI JV, LLC, offers MRI services located at New Milford Hospital. The New Milford Hospital owned a 51% share of New Milford MRI JV, LLC with the remaining 49% owned by Radcorp of New Milford, LLC. In September 2012, the Hospital purchased Radcorp of New Milford, LLC's ownership share and New Milford MRI JV, LLC became a department of the Hospital.

Use of Estimates

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

Regulatory Matters

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

Cash and Cash Equivalents

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

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

1. Summary of Significant Accounting Policies (continued)

Patient Accounts Receivable

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

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

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

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

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

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

The Hospital's primary concentration of credit risk is patient accounts receivable, which consists of amounts owed by various governmental agencies, insurance companies and private patients. The Hospital manages the receivables by regularly reviewing its patient accounts and contracts, and by providing appropriate allowances for uncollectible amounts. Significant concentrations of gross patient accounts receivable include 37% and 5%, and 37% and 6%, for Medicare and Medicaid, respectively, at September 30, 2013 and 2012, respectively.

Fair Value of Financial Instruments

The carrying value of financial instruments classified as current assets and current liabilities as of September 30, 2013 and 2012 approximate fair value based on current market conditions. The fair values of other financial instruments are disclosed in the respective notes and/or in Note 4.

Investments and Assets Limited as to Use

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

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

Inventories

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

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. The Hospital provides for depreciation of property, plant and equipment using the straight-line method in amounts sufficient to depreciate the cost of its assets over their estimated useful lives. The remaining useful lives range from 1 to 40 years.

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

1. Summary of Significant Accounting Policies (continued)

Nonoperating Income (Loss)

Activities other than those in connection with providing healthcare services are considered to be non-operating. Non-operating gains primarily consist of income and unrealized gains and losses on invested funds, unrestricted donations and contributions, and the change in the equity interest in unrestricted net assets of the Western Connecticut Health Network Foundation, Inc. Non-operating losses in 2012 include the operating expenses of the Foundation.

Deficiency of Revenues over Expenses

The consolidated statements of operations and changes in net assets include the deficiency of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from the deficiency of revenues over expenses 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, change in pension funding obligation, transfers to related entities, acquisition of non-controlling interest in joint venture and change in equity interest of the Western Connecticut Health Network Foundation, Inc.

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

Professional Liability Insurance

Professional liability insurance coverage was provided under claims-made policies. The coverage limits are \$5,000,000 per claim and \$25,000,000 in the aggregate. The excess indemnity coverage is \$25,000,000 per claim and \$25,000,000 in the aggregate. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. Management estimates and records a liability for incurred but not reported incidents (IBNR). The Hospital has recorded \$1,065,668 and \$1,439,898 based on a discount rate of 3.5% as of September 30, 2013 and 2012, respectively. The actuarially determined present value of the IBNR is included within accrued pension liabilities and other on the consolidated balance sheets.

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Income Taxes

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

At September 30, 2013, the Hospital has net operating loss carry-forwards from unrelated business activities of approximately \$1,678,000. These losses generate a potential deferred tax asset of approximately \$671,000, which is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future periods.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time frame or purpose. Temporarily restricted net assets consist of contributions restricted for certain health care services. Permanently restricted net assets consist of the Hospital's interest in Western Connecticut Health Network Foundation, Inc. assets held in trusts by others, which are to be maintained in perpetuity.

Donor Restricted Gifts

Unconditional promises to give cash and other assets to the Foundation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received and when the conditions are met. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

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

1. Summary of Significant Accounting Policies (continued)

Interest in the Western Connecticut Health Network Foundation, Inc.

Interest in the Western Connecticut Health Network Foundation, Inc. represents the Hospital's interest in the net assets of the Western Connecticut Health Network Foundation, Inc. and is accounted for in accordance with Accounting Standards Codification 958-20, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*.

2. Net Patient Service Revenue and Charity Care

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

	Year Ended September 30	
	2013	2012
Gross patient service revenue	\$ 184,161,328	\$ 204,381,627
Deductions:		
Allowances	110,830,443	121,534,978
Charity care	1,048,931	1,610,576
	111,879,374	123,145,554
Net patient service revenue	72,281,954	81,236,073
Provision for bad debt	2,560,334	3,125,172
Net patient service revenue less provision for bad debt	\$ 69,721,620	\$ 78,110,901

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

During 2013 and 2012, approximately 34% and 6%, and 31% and 7%, respectively, of net patient service revenue was received under the Medicare and Medicaid programs, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Hospital believes it is in compliance with all applicable laws and regulations. Changes in the Medicaid and Medicare programs and the reduction in funding levels could have an adverse impact on the Hospital.

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

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

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. The difference is accounted for as allowances. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, fee-for-service, discounted charges and per diem payments. Net patient service revenue is affected by the State of Connecticut Disproportionate Share program and is reported at the estimated net realizable amounts due from patients, third-party payors and others for services rendered and includes estimated retroactive revenue adjustments due to ongoing and future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations. During 2013 and 2012, the Hospital recorded increases in net patient service revenue of approximately \$400,000 and \$1,500,000, respectively, related to changes in previously estimated third party payor settlements.

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

Patient service revenue, net of contractual allowances and charity care and before the provision for bad debts, recognized in the period from major payor sources is as follows:

	Year Ended September 30	
	2013	2012
Third-party payors	\$ 69,571,079	\$ 77,538,501
Self-pay patients	2,710,875	3,697,572
	<u>\$ 72,281,954</u>	<u>\$ 81,236,073</u>

It is the policy of the Hospital to provide necessary care to all persons seeking treatment without discrimination on the grounds of age, race, creed, national origin or any other grounds unrelated to an individual's need for the service or the availability of the needed service at the Hospital. A patient is classified as a charity care patient by reference to the established policies of the Hospital. Essentially, these policies define charity care services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Hospital utilizes the generally

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

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

recognized Federal poverty income guidelines, but also includes certain cases where incurred charges are significant when compared to a responsible party's income. Those charges are not included in net patient service revenue for financial reporting purposes.

The estimated cost of charity care provided was approximately \$410,800 and \$670,900 for the years ended September 30, 2013 and 2012, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

3. Investments and Assets Limited as to Use

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

	September 30			
	2013		2012	
	Cost	Fair Value	Cost	Fair Value
Investments and funds restricted by donor:				
Cash and cash equivalents	\$ -	\$ -	\$ 1,691,858	\$ 1,691,858
U.S. government securities			100,394	103,471
Corporate and foreign bonds	-	-	902,718	923,367
Mutual funds	-	-	400,000	408,602
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,094,970</u>	<u>\$ 3,127,298</u>

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

In 2012, the Hospital's unrestricted portion of the investment portfolio reported in the accompanying consolidated balance sheets is designated as trading, with realized and unrealized gains and losses included in the deficiency of revenues over expenses.

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

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

4. Fair Values of Financial Instruments

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

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

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

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

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

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

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

4. Fair Values of Financial Instruments (continued)

Financial assets carried at fair value in the accompanying consolidated balance sheets for the fiscal year ending September 30, 2013 consist of only cash and cash equivalents of \$2,221,385, which are classified as Level 1 assets. For the fiscal year ending September 30, 2012, financial assets are classified in the table below in one of the three categories described above:

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

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

Financial assets carried at fair value included in the defined benefit pension plan (see Note 9) are classified in the table below in one of the three categories described above:

	September 30, 2013			Total
	Level 1	Level 2	Level 3	
Mutual funds:				
Domestic equity	\$ 23,505,440	\$ --	\$ --	\$ 23,505,440
International equity	3,214,773	--	--	3,214,773
Fixed income	20,824,167	--	--	20,824,167
Other	2,906,636	--	--	2,906,636
	<u>\$ 50,451,016</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 50,451,016</u>

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

4. Fair Values of Financial Instruments (continued)

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

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

5. Pledges Receivable

Pledges receivable include the following unconditional promises to give:

	September 30	
	2013	2012
Due within one year	\$ –	\$ 913,584
Due within one to five years	–	2,776,150
	–	3,689,734
Discount and allowance for uncollectible pledges	–	(186,910)
Present value of pledges receivable	<u>\$ –</u>	<u>\$ 3,502,824</u>

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

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

6. Long-Term Debt and Capital Leases

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

	September 30	
	2013	2012
Term loans	\$ —	\$ 466,426
Capital lease obligations	—	1,042,429
	—	1,508,855
Less: current portion	—	(495,090)
	\$ —	\$ 1,013,765

On June 11, 2010, the Hospital entered into a leasing agreement with First Litchfield Leasing Corporation to lease a 64-slice CT Scanner in the amount of \$1,008,023. Lease payments of \$56,993 are due quarterly beginning July 1, 2010 through April 1, 2015, at which point the Hospital has the option to purchase the machine for \$1. The equipment lease agreement bears interest at 1.33% quarterly. The outstanding balance of the capital lease was \$579,539 as of September 30, 2012. The lease obligation was fully repaid in July 2013.

On October 7, 2010, the Hospital entered into a leasing agreement with First Litchfield Leasing Corporation to lease a medical linear accelerator in the amount of \$722,405. Lease payments of \$40,845 are due quarterly beginning November 1, 2010 through August 1, 2015, at which point the Hospital has the option to purchase the machine for \$1. The equipment lease agreement bears interest at 1.33% quarterly. The outstanding balance of the capital lease was \$450,173 as of September 30, 2012. The lease obligation was fully repaid in July 2013.

On June 9, 2010, New Milford MRI JV, LLC entered into a loan agreement with Siemens Financial Services, Inc. in the amount of \$700,000 to help finance the construction and legal costs associated with the joint venture MRI project. Principal and interest are paid monthly in the amount of \$13,092 beginning in October 2010 through October 2015. The loan agreement bears interest at 4.63%. The outstanding balance as of September 30, 2012 was \$439,239. The carrying value of the loan approximates fair value as of September 30, 2012. This loan was fully repaid in June 2013.

Substantially, all assets owned by the Hospital were pledged as collateral for the term loans, as of September 30, 2012.

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

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

Interest paid on long-term debt in 2013 and 2012 amounted to \$82,362 and \$163,282, respectively.

7. Commitments and Contingencies

Litigation

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

Workers' Compensation Insurance

The Hospital is self-insured for workers' compensation benefits. Liabilities of \$463,981 and \$489,961, using a discount rate of 5.6% and 3.0%, respectively, have been accrued as of September 30, 2013 and 2012, respectively, based on expected future payments pertaining to such years.

Operating Leases

The Hospital leases various equipment and facilities under operating leases expiring at various dates through 2016. Total rental expense charged to operations amounted to \$751,809 and \$738,097 in 2013 and 2012, respectively.

Future minimum payments required under non-cancellable operating leases with initial or remaining terms of one year or more consisted of the following as of September 30, 2013:

	<u>Operating Leases</u>
For the year ended September 30:	
2014	\$ 507,430
2015	419,990
2016	65,812
Total minimum lease payments	<u>\$ 993,232</u>

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

8. Related Party Transactions

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

	September 30	
	2013	2012
Danbury Hospital	\$ 8,136,246	\$ 8,258,913
Western Connecticut Health Network, Inc.	(91,678)	(2,344)
Western Connecticut Medical Group, P.C.	<u>946,307</u>	<u>616,655</u>
	8,990,875	8,873,224
Less: current portion	<u>(6,514,591)</u>	<u>(5,057,706)</u>
	<u>\$ 2,476,284</u>	<u>\$ 3,815,518</u>

Effective July 1, 2011, the Hospital entered into an agreement with Danbury Hospital to provide a term loan in the amount of \$6,640,229 for the payoff of the Hospital's term loans, interest rate swap, and promissory notes in June 2011. The term loan with Danbury Hospital bears interest at an annual rate of 4%. Payments of \$122,290 are due monthly beginning August 1, 2011 through July 1, 2016. The balance of the term loan was \$3,815,517 and \$5,102,326 as of September 30, 2013 and 2012, respectively. In addition, the Hospital has recorded a payable due to Danbury Hospital in the amount of \$4,320,729 and \$3,156,587 as of September 30, 2013 and 2012, respectively, for expenses, such as insurance, administrative, and other services provided by Danbury Hospital on behalf of New Milford Hospital.

9. Pension Plans

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

Effective January 31, 2010, the Hospital amended the Plan to close the Plan to new participants and to freeze accruals for all participants, other than those who were fifty-six years old and had at least ten years of service. The Plan was amended effective October 31, 2012 to cease the future accrual of benefits to each highly compensated employee as defined by the IRS.

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

9. Pension Plans (continued)

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

	September 30	
	2013	2012
Changes in benefit obligations		
Benefit obligations at beginning of year	\$ 67,330,037	\$ 53,606,689
Service cost	247,338	279,185
Interest cost	2,694,999	2,930,958
Amendment	(127,811)	-
Assumption changes	(8,434,543)	12,459,379
Actuarial (gain) loss	(561,522)	162,932
Benefits paid	(2,431,331)	(2,109,106)
Benefit obligations at end of year	<u>58,717,167</u>	<u>67,330,037</u>
Changes in plan assets		
Fair value of plan assets at beginning of year	46,434,477	38,325,360
Actual return on plan assets	4,464,247	6,917,318
Employer contribution	2,107,867	3,300,905
Expenses	(124,244)	-
Benefits paid	(2,431,331)	(2,109,106)
Fair value of plan assets at end of year	<u>50,451,016</u>	<u>46,434,477</u>
Underfunded status	<u>\$ (8,266,151)</u>	<u>\$ (20,895,560)</u>
Components of net periodic benefit cost		
	2013	2012
Service cost	\$ 247,338	\$ 279,185
Interest cost	2,694,999	2,930,958
Expected return on plan assets	(3,689,438)	(3,113,701)
Amortization of prior service cost	(42,604)	-
Recognized net loss	2,089,996	1,544,439
Net periodic benefit cost	<u>\$ 1,300,291</u>	<u>\$ 1,640,881</u>

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

9. Pension Plans (continued)

Assumptions

	<u>2013</u>	<u>2012</u>
Weighted-average assumptions used to determine benefit obligations		
Discount rate	5.23%	4.12%
Rate of increase in compensation	3.00%	3.00%
Weighted-average assumptions used to determine net periodic benefit cost		
Discount rate	4.12%	5.56%
Rate of increase in compensation	3.00%	3.00%
Expected long-term return on plan assets	8.00%	8.00%

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

Amounts recorded in unrestricted net assets and not yet amortized as components of net periodic benefit costs total \$17,161,061 and \$28,982,894 as of September 30, 2013 and 2012, respectively, and represent unrecognized actuarial losses. The amortization of these components expected to be recognized in net periodic costs for the year ended September 30, 2014 is \$1,050,052.

The accumulated benefit obligation was \$58,310,526 and \$66,431,677 as of September 30, 2013 and 2012, respectively. The Plan's measurement date is September 30.

Plan Assets

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

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

9. Pension Plans (continued)

As discussed in Note 4, the Hospital follows a three-level hierarchy to categorize assets measured at fair value. In accordance with the hierarchy, as of September 30, 2013 and 2012, 100% of the Plan assets were categorized as Level 1 investments. Securities with readily determinable values are carried at fair value as determined based on independent public sources.

Contributions

Management expects to contribute \$884,000 to the Plan during fiscal year 2014.

Estimated Future Benefit Payments

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

2014	\$ 2,768,577
2015	2,869,755
2016	2,993,547
2017	3,201,278
2018	3,334,473
Years 2019-2023	19,075,625

Tax Sheltered Annuity

A Tax Shelter Annuity (TSA) plan is available to substantially all employees. New participants may elect to contribute up to 20% of pretax compensation not to exceed \$17,500 and \$17,000 in calendar year 2013 and 2012, respectively, with certain "catch-up" provisions for employees over fifty years of age. The participants are fully vested in their contributions from the date of contribution. Effective January 1, 2003, employees with hire dates after October 1, 1988 are eligible to receive a Hospital TSA matching contribution equal to 1% of their salary provided the employee deposits at least that same amount to their TSA account. This percentage increased to 2% in calendar year 2004 and to 3% beginning in calendar year 2005. The TSA was frozen to new contributions as of December 31, 2011. The Hospital established a new defined contribution plan for all employees during fiscal year 2012. The expense related to the defined contribution plans was \$1,246,644 and \$1,792,356 for the years ended September 30, 2013 and 2012, respectively.

The New Milford Hospital, Incorporated and Subsidiary

Notes to Consolidated Financial Statements (continued)

9. Pension Plans (continued)

Supplemental Executive Retirement Plan (SERP)

Effective December 21, 2007, the Hospital adopted a SERP under section 457(b) of the Internal Revenue Code of 1986, as amended. The Hospital adopted a second SERP, effective June 30, 2008 under section 457(f) of the Internal Revenue Code of 1986, as amended. The SERP is pursuant to the Employee Retirement Income Security Act of 1974. The SERP has been established to supplement the retirement benefits of eligible employees designated by the Hospital's Board of Directors. The accrued liability relating to the SERP amounted to \$72,459 and \$100,798 as of September 30, 2013 and 2012, respectively, and is included within other accrued expenses on the consolidated balance sheets. The expenses incurred related to the SERP amounted to \$4,030 and \$5,640 for the years ended September 30, 2013 and 2012, respectively. Effective October 1, 2009, the SERP was frozen. Provisions have been made to "grandfather" those participants in the plan that are sixty years old and have at least ten years of service.

10. Net Assets

Temporarily restricted net assets of \$4,125,215 and \$3,923,984 as of September 30, 2013 and 2012, respectively, are available to the Hospital for capital expenditures. Permanently restricted net assets total \$4,269,475 and \$4,134,546 as of September 30, 2013 and 2012, respectively, and represent the Hospital's interest in Western Connecticut Health Network Foundation, Inc., the income from which is expendable to support health care services.

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

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

	Year Ended September 30	
	2013	2012
(Increase) decrease in operating assets:		
Pledges receivable	\$ —	\$ (3,229,016)
Accounts receivable, net	(1,273,813)	(1,269,048)
Inventories	123,909	299,398
Prepaid expenses and other assets	234,989	(2,623,567)
	(914,915)	(6,822,233)
Increase (decrease) in operating liabilities:		
Accounts payable	(536,162)	(1,181,356)
Payroll-related accruals	(811,697)	873,721
Due to third-party payors	(488,062)	(1,723,074)
Other accrued expenses	(102,437)	(655,378)
Accrued pension liabilities and other	(1,135,168)	1,320,575
	(3,073,526)	(1,365,512)
Change in working capital other than cash and cash equivalents	\$ (3,988,441)	\$ (8,187,745)

12. Functional Expenses

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

	Year Ended September 30	
	2013	2012
Patient care services	\$ 50,850,826	\$ 59,693,994
General and administrative	22,111,473	25,490,979
	\$ 72,962,299	\$ 85,184,973

13. Subsequent Events

Subsequent events have been evaluated through January 21, 2014, which represents the date the consolidated financial statements were issued. No events have occurred that require disclosure in or adjusted to the consolidated financial statements.

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