

COMBINED FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

Windham Community Memorial Hospital, Inc., and Affiliates  
Years Ended September 30, 2013 and 2012  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

Windham Community Memorial Hospital, Inc., and Affiliates

Combined Financial Statements  
and Supplementary Information

Years Ended September 30, 2013 and 2012

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## Report of Independent Auditors

The Board of Directors  
Hartford HealthCare Corporation

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

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of Windham Community Memorial Hospital, Inc., and Affiliates at September 30, 2013 and 2012, and the combined 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.

## **Supplementary Information**

Our audits were performed for the purpose of forming an opinion on the combined financial statements as a whole. The combining balance sheet and statement of operations are presented for the purposes of additional analysis and are not required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, based on our audit and the report of other auditors, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.

*Ernst + Young LLP*

January 31, 2014

Windham Community Memorial Hospital, Inc., and Affiliates

Combined Balance Sheets

	<b>September 30</b>	
	<b>2013</b>	<b>2012</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 7,575,725	\$ 4,122,969
Accounts receivable, less allowances for doubtful accounts of approximately \$3,800,000 in 2013 and \$3,039,000 in 2012	<b>11,889,554</b>	20,670,040
Other receivables	<b>4,113,239</b>	4,081,376
Due from affiliates	<b>1,047,418</b>	3,066
Inventories of supplies	<b>1,150,602</b>	1,105,978
Prepaid expenses and other assets	<b>391,222</b>	462,549
Current portion of assets whose use is limited	<b>560,838</b>	654,986
Total current assets	<b>26,728,598</b>	31,100,964
Assets whose use is limited:		
Interest in investments held by Endowment LLC	<b>72,341</b>	-
Investments and other assets	<b>378,132</b>	406,468
Donor-restricted interest in investments held by Endowment LLC	<b>1,833,758</b>	-
Investments for restricted purposes	<b>83,070</b>	1,597,574
Funds designated for debt service	<b>1,439,934</b>	1,439,934
	<b>3,807,235</b>	3,443,976
Funds held in trust by others	<b>3,030,775</b>	2,831,893
Other assets	<b>2,434,811</b>	3,123,242
Property, plant, and equipment, net	<b>44,147,690</b>	39,646,124
Total assets	<b>\$ 80,149,109</b>	\$ 80,146,199

	<b>September 30</b>	
	<b>2013</b>	<b>2012</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 3,399,075	\$ 7,315,960
Salaries, wages, payroll taxes, and amounts withheld from employees	2,012,866	1,813,588
Accrued expenses	1,125,033	1,075,837
Due to affiliates	1,134,172	2,845,310
Third-party payor settlements	1,340,072	1,499,004
Current portion of long-term debt and capital leases	15,740,918	11,337,796
Current portion of accrued pension liability	5,090,126	5,125,668
Total current liabilities	<u>29,842,262</u>	<u>31,013,163</u>
Long-term debt and capital leases	19,355,130	19,433,376
Accrued pension liability	26,560,346	64,662,899
Interest rate swap obligation	2,701,010	4,387,733
Other liabilities	9,139,818	3,171,975
Total liabilities	<u>87,598,566</u>	<u>122,669,146</u>
Net assets:		
Unrestricted	(13,430,049)	(47,943,489)
Temporarily restricted	1,786,651	1,453,029
Permanently restricted	4,193,941	3,967,513
Total net assets	<u>(7,449,457)</u>	<u>(42,522,947)</u>
Total liabilities and net assets	<u>\$ 80,149,109</u>	<u>\$ 80,146,199</u>

*See accompanying notes.*

Windham Community Memorial Hospital, Inc., and Affiliates

Combined Statements of Operations and Changes in Net Assets

	<b>Year Ended September 30</b>	
	<b>2013</b>	<b>2012</b>
Unrestricted revenues, gains, and other support:		
Net patient service revenue	\$ 80,793,701	\$ 90,160,381
Provision for bad debts <i>(Note 1)</i>	<b>4,079,212</b>	3,122,185
Net patient service revenue less provision for bad debts	<b>76,714,489</b>	87,038,196
Other operating revenue	<b>5,690,246</b>	5,420,274
Net assets released from restrictions for operations	<b>175,864</b>	341,424
	<b>82,580,599</b>	92,799,894
Operating expenses:		
Salaries and wages	<b>41,730,362</b>	42,907,325
Employee benefits	<b>12,666,864</b>	15,336,446
Supplies and other	<b>17,202,793</b>	17,578,072
Purchased services	<b>13,896,261</b>	11,316,349
Depreciation and amortization	<b>4,154,949</b>	4,147,105
Provision for nonpatient bad debts	<b>608,820</b>	717,092
Interest	<b>1,107,869</b>	1,325,543
	<b>91,367,918</b>	93,327,932
Operating loss	<b>(8,787,319)</b>	(528,038)
Nonoperating income (loss):		
Income from investments, gifts, and bequests, net	<b>498,134</b>	756,073
Other	<b>1,070,641</b>	(941,371)
	<b>1,568,775</b>	(185,298)
Deficiency of revenues over expenses	<b>(7,218,544)</b>	(713,336)

Windham Community Memorial Hospital, Inc., and Affiliates

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

	<b>Year Ended September 30</b>	
	<b>2013</b>	<b>2012</b>
Unrestricted net assets:		
Deficiency of revenues over expenses	\$ (7,218,544)	\$ (713,336)
Net assets released from restriction for purchase of property and equipment	22,202	71,939
Change in pension and postretirement funding obligation	34,385,130	(11,323,642)
Transfer from Hartford HealthCare	7,324,652	–
Increase (decrease) in unrestricted net assets	<u>34,513,440</u>	<u>(11,965,039)</u>
Temporarily restricted net assets:		
Restricted contributions	325,222	301,983
Restricted investment income	22,215	67,771
Return on interest in investments held by Endowment LLC	184,251	–
Change in unrealized gains on investments	–	178,102
Net assets released from restrictions for operations	(175,864)	(341,424)
Net assets released from restriction for purchase of property and equipment	(22,202)	(71,939)
Increase in temporarily restricted net assets	<u>333,622</u>	<u>134,493</u>
Permanently restricted net assets:		
Restricted contributions	4,662	4,200
Restricted investment income	7,464	26,473
Return on interest in investments held by Endowment LLC	15,420	–
Change in unrealized gains of funds held in trust	198,882	326,499
Increase in permanently restricted net assets	<u>226,428</u>	<u>357,172</u>
Increase (decrease) in net assets	<b>35,073,490</b>	<b>(11,473,374)</b>
Net assets at beginning of year	<u>(42,522,947)</u>	<u>(31,049,573)</u>
Net assets at end of year	<u><b>\$ (7,449,457)</b></u>	<u><b>\$ (42,522,947)</b></u>

See accompanying notes.

Windham Community Memorial Hospital, Inc., and Affiliates

Combined Statements of Cash Flows

	<b>Year Ended September 30</b>	
	<b>2013</b>	<b>2012</b>
<b>Operating activities</b>		
Increase (decrease) in net assets	\$ 35,073,490	\$ (11,473,374)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Noncash items:		
Depreciation and amortization	4,154,949	4,147,105
Change in unrealized gains and losses on investments	(26,529)	(178,101)
Change in investments held by Endowment LLC	(202,156)	-
Change in unrealized gains and losses on funds held in trust by others	(198,882)	(326,499)
Provision for patient bad debts	4,079,212	3,122,185
Provision for non-patient bad debts	608,820	717,092
Change in net assets related to pension and postretirement funding obligations	(34,385,130)	11,323,642
Transfer from Hartford HealthCare	(7,324,652)	-
Change in fair value of interest rate swap agreements	(1,686,723)	139,604
Other changes in net assets:		
Changes in assets and liabilities, net ( <i>Note 13</i> )	3,080,243	(6,371,880)
Restricted contributions and investment income	(359,563)	(400,427)
Net cash provided by operating activities	<u>2,813,079</u>	<u>699,347</u>
<b>Investing activities</b>		
Investment in real estate	55,869	37,153
Purchase of property, plant, and equipment, net	(8,133,991)	(6,985,467)
(Increase) decrease in assets whose use is limited, net	(40,426)	94,160
Net cash used in investing activities	<u>(8,118,548)</u>	<u>(6,854,154)</u>
<b>Financing activities</b>		
Payments on long-term debt	(396,734)	(3,782,229)
Net borrowings under line of credit agreement	4,199,086	11,156,896
Transfer from affiliates	4,596,310	-
Restricted contributions and investment income	359,563	400,427
Net cash provided by financing activities	<u>8,758,225</u>	<u>7,775,094</u>
Net increase in cash and cash equivalents	<u>3,452,756</u>	<u>1,620,287</u>
Cash and cash equivalents at beginning of year	<u>4,122,969</u>	<u>2,502,682</u>
Cash and cash equivalents at end of year	<u>\$ 7,575,725</u>	<u>\$ 4,122,969</u>

See accompanying notes.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements

September 30, 2013

### **1. Significant Accounting Policies**

The accounting policies that affect significant elements of Windham Community Memorial Hospital, Inc. and Affiliates' (Windham or the Hospital) financial statements are summarized below and in Note 2.

#### **Organization**

Windham Community Memorial Hospital, Inc. is a voluntary association incorporated under the General Statutes of the State of Connecticut, and as of March 2009, is a subsidiary of Hartford HealthCare Corporation (HHC). The Board of Trustees of Windham, appointed by HHC, controls the operations of Windham. The accompanying combined financial statements include Windham Community Memorial Hospital, Inc., The Hatch Hospital Corporation, and the Windham Hospital Foundation, Inc. (together, the Hospital). All material intercompany accounts and transactions have been eliminated in the accompanying combined financial statements.

Windham, located in Willimantic, Connecticut, is a nonprofit acute care hospital. Windham provides inpatient, outpatient, and emergency care services for residents of Northeastern Connecticut.

The Hatch Hospital Corporation (Hatch) is a nonprofit organization incorporated under the General Statutes of the State of Connecticut. Its purpose is to promote, foster, aid, carry out and fulfill the aims, objectives, and purposes of the trust created under the Tenth Clause of the will of George Hatch. Periodically, amounts are transferred from the trust to Hatch for expenses as the need arises.

Windham Hospital Foundation, Inc. (Foundation) is a nonprofit organization incorporated under the General Statutes of the State of Connecticut. Its purpose is to promote and solicit charitable support for the purposes of Windham.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### **1. Significant Accounting Policies (continued)**

#### **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

#### **Regulatory Matters**

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

#### **Fair Value of Financial Instruments**

The carrying value of financial instruments classified as current assets and current liabilities approximate fair value. The fair values of the Hospital's financial instruments are disclosed in Note 5.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash, commercial paper, and corporate and government bonds, that are available to be converted to liquid assets within three months. 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.

#### **Patient Accounts Receivable**

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

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### **1. Significant Accounting Policies (continued)**

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

The Hospital's primary concentration of credit risk is patient accounts receivable, which consist 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 30% and 12%, and 38% and 14%, for Medicare and Medicaid, respectively, for the fiscal years ending September 30, 2013 and 2012, respectively.

### **Interest in Investments Held by Hartford Healthcare Endowment LLC**

Effective August 29, 2011, Hartford HealthCare Endowment LLC (Endowment LLC) was created to maintain and manage, on a pooled basis, the endowment funds of the Hospital; MidState Medical Center; Hartford Hospital; The Hospital of Central Connecticut at New Britain General and Bradley Memorial; HHC; and Hartford HealthCare at Home, Inc. Endowment LLC, a wholly owned subsidiary of HHC, acts as manager, and is named fiduciary for HHC within established investment guidelines. As of April 1, 2013, \$1,796,350 of the Hospital's investments were sold to Endowment LLC, at which time all previously unrealized gains and losses on the sold investments were realized. As of September 30, 2013, the Hospital has an interest in investments held by Endowment LLC, which is reflected in the accompanying combined balance sheets and represents the Hospital's pro rata share of Endowment LLC.

The Hospital reports its share of the increase or decrease in Endowment LLC as income or loss from investments in the excess of revenues over expenses, unless the income or loss is restricted by donor or law. Investments held by Endowment LLC in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations at the combined balance sheet date. Alternative investments (non-traditional, not-readily-marketable assets), some of which are structured such that Endowment LLC holds limited partnership interest, are reported based upon net asset value and derived from the application of the equity method of accounting. Individual investment holdings within the alternative investments may, in turn, include investments in both nonmarketable and market-traded securities. Valuations of these investments and, therefore, Endowment LLC's holdings may be determined by the investment manager or general partner

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### **1. Significant Accounting Policies (continued)**

and for “funds of funds” investments are primarily based on financial data supplied by the underlying investee funds. Values may be used on historical cost, appraisals, or other estimates that require varying degrees of judgment. Endowment LLC accounts for these investments using the equity method of accounting and reports its share of the increase or decrease in the funds’ value as investment gain or loss. The financial statements of the investees are audited annually by independent auditors, although the timing for reporting the results of such audits does not coincide with Endowment LLC’s annual consolidated financial statement reporting.

#### **Investments**

The Hospital’s investment portfolio is classified as trading, excluding the interest in Endowment LLC, with unrealized gains and losses included in the deficiency of revenues over expenses.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations at the balance sheet date. Assets temporarily and permanently restricted (by donor) are recorded at fair value at the date of donation, which is then considered cost. Investment income (including realized gains and losses on investments, interest and dividends, and the change in unrealized gains and losses) is included in non-operating income unless the income or loss is restricted by the donor or law. The cost of securities sold is based on the specific identification method.

#### **Inventories**

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

#### **Property, Plant, and Equipment**

Property, plant, and equipment is stated on the basis of cost. The Hospital provides for depreciation of property, plant, and equipment and assets under capital leases using the straight-line method in amounts sufficient to depreciate the cost of the assets over their estimated useful lives, which range from 3 to 40 years.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### **1. Significant Accounting Policies (continued)**

#### **Assets Whose Use is Limited**

Assets whose use is limited includes assets that are set aside internally by management or by the Board of Directors for future capital improvements, research, donor-restricted assets, education, escrow funds, and debt service funds for existing obligations on outstanding long-term debt. Amounts that are restricted by the Board of Directors are not available for use without the approval of the Board of Directors. Investments for restricted purposes are those restricted based on donors' intents.

#### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those assets whose use by the Hospital has been limited by donors to a specific time frame or purpose. Permanently restricted net assets have been restricted by donors and are maintained by the Hospital in perpetuity. The Hospital is a partial beneficiary to various perpetual trust agreements. Assets recorded under these agreements are recognized at fair value. The investment income generated from these trusts is expendable to support healthcare services, and the assets are classified as permanently restricted.

Contributions, including unconditional promises to give, are recognized as revenue in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Unrestricted contributions are recorded, net of expenses, within non-operating revenue.

Pledges receivable to be received after one year are discounted to present value and an allowance for uncollectible pledges is recorded. Amortization of the discount is recognized as revenue and is reflected in accordance with donor-imposed restrictions, if any, on the contributions.

#### **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 support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the combined statements of operations and changes in net assets as net assets released

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### **1. Significant Accounting Policies (continued)**

from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are unrestricted contributions in the accompanying combined financial statements, except those relating to donations of long-lived assets.

#### **Bond Issuance Costs**

Bond issuance costs associated with long-term debt for capital projects are amortized over the term of the debt using a method that approximates the effective interest method. Bond issuance costs of \$263,600 and \$273,015 are recorded in other assets in the accompanying combined balance sheets as of September 30, 2013 and 2012, respectively.

#### **Interest Rate Swap Agreements**

The Hospital utilizes interest rate swap agreements to reduce risks associated with changes in interest rates. The Hospital does not hold or issue derivative financial instruments for trading purposes. The Hospital may be exposed to credit loss in the event of non-performance by the counterparties to its interest rate swap agreements. Interest rate swap agreements are reported at fair value. Changes in fair value are recognized in the performance indicator in the accompanying combined statements of operations and changes in net assets.

#### **Other Operating Revenue**

Other operating revenue includes services to other institutions, electronic health record (EHR) incentive program revenue, rental income, grant income, research income, and unrestricted contributions.

#### **Nonoperating Income**

Nonoperating income includes income on investments, realized and unrealized gains and losses on trading investments, restricted gifts, bequests, and changes in fair value of swap agreements.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### **1. Significant Accounting Policies (continued)**

#### **Deficiency of Revenues over Expenses**

The combined 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 the changes in pension and postretirement obligation, net assets released from restrictions for the purchase of property and equipment, and transfers of assets to and from affiliates.

#### **Professional Liability Insurance**

Coverage for medical malpractice insurance is provided on a claims-made basis. The primary coverage is with CHS Insurance Limited, a captive insurance company that, effective October 1, 2012, became a wholly owned subsidiary of HHC.

On October 1, 2012, the policy limits were amended. The primary coverage went from \$10,000,000 per claim and \$39,000,000 in the aggregate to \$7,500,000 per claim and \$35,000,000 in the aggregate. The excess plan was restructured as well. The primary layer of \$20,000,000 is shared with two insurance carriers. The secondary layer is \$20,000,000 with a single insurance carrier. The third and fourth layers are \$10,000,000 each with two other insurance carriers, for a total excess coverage of \$60,000,000. Malpractice claims are discounted at 2.08% and 2.49% and the incurred-but-not-reported liability was \$317,000 and \$298,000 at September 30, 2013 and 2012, respectively.

#### **Income Taxes**

Windham, Hatch, and the Foundation are not-for-profit corporations as described in Section 501 (c) (3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501 (a) of the Code.

#### **Electronic Health Record Incentive Program**

The Centers for Medicare & Medicaid Services (CMS) have implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments for the meaningful use of certified EHR technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### **1. Significant Accounting Policies (continued)**

The Medicare EHR incentive program provides annual incentive payments to eligible professionals, hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology. The Hospital uses a grant accounting model to recognize EHR incentive revenues. EHR incentive revenues are recognized ratably over the relevant cost report period to determine the amount of reimbursement. The Hospital recognized approximately \$1,800,000 and \$2,400,000 of EHR revenues during the fiscal years ended September 30, 2013 and 2012, respectively. Correspondingly, the Medicare and Medicaid components, respectively, of EHR revenues are \$1,500,000 and \$300,000 and \$1,900,000 and \$500,000 for 2013 and 2012, respectively. EHR incentive revenues are included in other operating revenue in the accompanying combined statements of operations and changes in net assets.

The Hospital's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, Medicare EHR incentive payments received are subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated.

### **New Accounting Pronouncement**

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, to amend the requirement for measuring and disclosing information about fair value that results in common principles between GAAP and International Financial Reporting Standards (IFRSs). The amendments clarify the FASB's intent about the application of existing fair value measurement and disclosure requirements and change particular principles and requirements for measuring or disclosing information about fair value. Principles changed include measuring fair value of financial instruments that are managed within a portfolio, application of premiums and discounts in the fair value measurement, and additional disclosures about fair value measurements. The standard became effective for the Hospital for annual reporting periods beginning after December 15, 2011. The Hospital adopted the provisions of this standard on October 1, 2012. The adoption had no effect on previously reported deficiency of revenues over expenses or net assets.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### **1. Significant Accounting Policies (continued)**

#### **Reclassifications**

Certain reclassifications have been made to the fiscal year ended September 30, 2012, balances previously reported in the combined balance sheet and statement of operations and changes in net assets in order to conform with the fiscal year ended September 30, 2013, presentation.

### **2. Net Patient Service Revenue and Charity Care**

Revenues from Medicare and Medicaid programs, respectively, accounted for approximately 39% and 8%, and 43% and 8%, of the Hospital's net patient service revenue for the fiscal years ended September 30, 2013 and 2012, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

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

The following table summarizes net revenues from services to patients:

	<b>Year Ended September 30</b>	
	<b>2013</b>	<b>2012</b>
Gross revenues from patients:		
Inpatients	\$ 68,069,832	\$ 68,939,980
Outpatients	137,339,554	141,210,109
	<u>205,409,386</u>	<u>210,150,089</u>
Deductions:		
Allowances and discounts	121,754,445	116,283,387
Charity care	2,861,240	3,706,321
Net patient revenue	<u>80,793,701</u>	<u>90,160,381</u>
Provision for bad debts	4,079,212	3,122,185
Net patient service revenue less provision for bad debts	<u>\$ 76,714,489</u>	<u>\$ 87,038,196</u>

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 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 net changes in estimates of approximately \$308,000 and \$538,000, respectively, which primarily related to better than 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 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

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

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

the accompanying combined balance sheets. Additionally, certain payers' payment rates for various years have been appealed by the Hospital. If the appeals are successful, additional income applicable to those years might be realized.

The Hospital has agreements with various health maintenance organizations (HMOs) to provide medical services to subscribing participants. Under those agreements, the HMOs make fee-for-service payments to the Hospital for certain covered services based upon discounted fee schedules.

The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to the established policies of the Hospital. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Hospital utilizes the generally recognized poverty income levels for the State of Connecticut but also includes certain cases where incurred charges are significant when compared to incomes.

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 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.
- Various allowance coverage statistics.

The Hospital regularly performs hindsight procedures to evaluate historical write-off and collection experience throughout the year to help determine the reasonableness of its process for estimating the allowance for doubtful accounts.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

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

The Hospital provides services without charge or at amounts less than its established rates, to patients who meet the criteria of its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such services are not reported as revenue. For patients who were determined by the Hospital to have the ability to pay but did not, the uncollected amounts are recorded as part of the provision for bad debts. In distinguishing charity care from the provision for bad debts, a number of factors are considered, certain of which require a high degree of judgment.

Patient service revenue, net of contractual allowances and discounts and before the provision for bad debts, recognized in the period from major payor sources for the fiscal years ended September 30, 2013 and 2012, is as follows:

	<u>2013</u>	<u>2012</u>
Medicare	<b>39%</b>	43%
Medicaid	<b>8</b>	8
Self-pay	<b>10</b>	9
All other	<b>43</b>	40
	<u><b>100%</b></u>	<u>100%</u>

The estimated cost of charity care provided was \$1,287,417 and \$1,696,172 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.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### 3. Net Assets

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

	<b>2013</b>	<b>2012</b>
Free beds	\$ <b>102,112</b>	\$ 80,941
Education	<b>304,704</b>	245,218
Capital replacement	<b>256,999</b>	262,664
Other health care services	<b>1,122,836</b>	864,206
	<b>\$ 1,786,651</b>	\$ 1,453,029

Permanently restricted net assets at September 30 are restricted for:

	<b>2013</b>	<b>2012</b>
Investments to be held in perpetuity, the income from which is expendable to support health care services	\$ <b>1,163,166</b>	\$ 1,135,620
Restricted funds held in trust by others, the income from which is expendable to support health care services	<b>3,030,775</b>	2,831,893
	<b>\$ 4,193,941</b>	\$ 3,967,513

The Hospital's endowment consists of various individual funds established for a variety of purposes. Those funds include donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Trustees of the Hospital has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### 3. Net Assets (continued)

temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted 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

The Hospital has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Hospital must hold in perpetuity or for a donor-specific period(s). Under the policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce a real return, net of inflation and investment management costs, of at least 4% over the long term. Actual returns in any given year may vary from this amount.

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

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**3. Net Assets (continued)**

The Hospital has a policy of appropriating for distribution each year 4% of the four quarter average market value of each fiscal year in which the distribution is planned. This is consistent with the Hospital's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment returns. The Hospital also evaluated endowment spending based on need and current market conditions as well as long-term investment goals.

Changes in endowment funds for the fiscal year ended September 30, 2013, consisted of the following:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 611,924	\$ 1,135,620	\$ 1,747,544
Investment return:			
Contributions	-	4,662	4,662
Investment income	22,215	7,464	29,679
Net appreciation (realized and unrealized)	184,251	15,420	199,671
Total investment return	206,466	27,546	234,012
Appropriation of endowment assets for expenditure	(17,314)	-	(17,314)
Endowment net assets, end of year	<u>\$ 801,076</u>	<u>\$ 1,163,166</u>	<u>\$ 1,964,242</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**3. Net Assets (continued)**

Endowment net asset composition by type (excluding funds held in trust by others) of fund as of September 30, 2013, consisted of the following:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-restricted endowment funds	\$ 729,647	\$ 1,104,111	\$ 1,833,758
Investments for restricted purposes	43,888	39,182	83,070
Current portion of assets whose use is limited	27,543	19,873	47,416
	<u>\$ 801,078</u>	<u>\$ 1,163,166</u>	<u>\$ 1,964,244</u>

Changes in endowment funds for the fiscal year ended September 30, 2012, consisted of the following:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets, beginning of year	\$ 647,096	\$ 1,104,947	\$ 1,752,043
Investment return:			
Investment income	67,771	4,200	71,971
Net appreciation (unrealized)	178,102	26,473	204,575
Total investment return	<u>245,873</u>	<u>30,673</u>	<u>276,546</u>
Appropriation of endowment assets for expenditure	<u>(281,045)</u>	<u>—</u>	<u>(281,045)</u>
Endowment net assets, end of year	<u>\$ 611,924</u>	<u>\$ 1,135,620</u>	<u>\$ 1,747,544</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**3. Net Assets (continued)**

Endowment net asset composition by type (excluding funds held in trust by others) of fund as of September 30, 2012, consisted of the following:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-restricted endowment funds	\$ 439,250	\$ 1,079,281	\$ 1,518,531
Investments for restricted purposes	46,679	32,364	79,043
Current portion of assets whose use is limited	125,995	23,975	149,970
	<u>\$ 611,924</u>	<u>\$ 1,135,620</u>	<u>\$ 1,747,544</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor, as stipulated by UPMIFA, requires the Hospital to retain as a fund of perpetual duration. These deficiencies periodically result from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions, in which case the Board of Directors may deem imprudent the continuation of appropriation for a limited period. There were no material deficiencies as of September 30, 2013 and 2012.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**4. Assets Whose Use is Limited**

Included in assets whose use is limited are the following amounts:

	<b>September 30</b>	
	<b>2013</b>	<b>2012</b>
Cash and cash equivalents	\$ 550,805	\$ 557,369
Money market funds	1,449,967	1,537,551
Interest in investments held by Endowment LLC	1,906,099	–
Equity securities:		
U.S.	107,426	311,301
Fixed income bonds:		
U.S.	–	112,549
Mutual funds:		
U.S.	289,816	1,478,595
International	53,214	90,894
Alternative investments and other	10,746	10,703
	<u>\$ 4,368,073</u>	<u>\$ 4,098,962</u>

During 2013, a significant portion of the Hospital's assets whose use is limited was transferred to Endowment LLC, as discussed in Note 1.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### 4. Assets Whose Use is Limited (continued)

The composition and presentation of income from investments, gifts, and bequests, net, which is included in nonoperating income (loss) in the accompanying combined statements of operations and changes in net assets, are as follows:

	<u>2013</u>	<u>2012</u>
Gifts and bequests	\$ 449,084	\$ 698,728
Return on interest in investments held by Endowment LLC	2,485	–
Unrealized gains on investments	26,529	51,801
Realized gains on investments	13,472	450
Interest and dividend income	11,063	9,215
Investment fees	(4,499)	(4,121)
	<u>\$ 498,134</u>	<u>\$ 756,073</u>

### 5. Fair Values of Financial Instruments

As defined in Accounting Standards Codification 820 *Fair Value Measurement*, fair value is 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. In order to increase consistency and comparability in fair value measurements, ASC 820 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

*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 are based on inputs not quoted in active markets, but corroborated by market data.

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

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**5. Fair Values of Financial Instruments (continued)**

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 non-performance risk in its assessment of fair value.

Financial assets and liabilities carried at fair value in the accompanying combined balance sheets, excluding assets invested in the Hospital's defined benefit pension plan and Endowment LLC, are classified in the following tables below in one of the three categories described above:

	<b>September 30, 2013</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Cash and cash equivalents	\$ 7,575,725	\$ –	\$ –	\$ 7,575,725
Assets whose use is limited:				
Cash and cash equivalents	550,805	–	–	550,805
Money market funds	1,449,967	–	–	1,449,967
Equity securities:				
U.S.	107,426	–	–	107,426
Mutual funds:				
U.S.	166,307	123,509	–	289,816
International	38,381	14,833	–	53,214
Funds held in trust by others	–	3,030,775	–	3,030,775
	<b>\$ 9,888,611</b>	<b>\$ 3,169,117</b>	<b>\$ –</b>	<b>\$ 13,057,728</b>
<b>Liabilities</b>				
Interest rate swaps	\$ –	\$ 2,701,010	\$ –	\$ 2,701,010

The amounts reported in the preceding table do not include alternative investments totaling \$10,746 as of September 30, 2013, that were accounted for under the equity method of accounting.

The Hospital has \$1,906,099 of financial assets as of September 30, 2013, that are held by Endowment LLC (refer to Note 1). Financial assets classified within the trust are 63.8% Level 1 and 36.2% Level 2.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**5. Fair Values of Financial Instruments (continued)**

	September 30, 2012			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 4,122,969	\$ –	\$ –	\$ 4,122,969
Assets whose is limited:				
Cash and cash equivalents	557,369	–	–	557,369
Money market funds	1,537,551	–	–	1,537,551
Equity securities:				
U.S.	311,301	–	–	311,301
Fixed income bonds:				
U.S.	–	112,549	–	112,549
Mutual funds:				
U.S.	918,469	560,126	–	1,478,595
International	67,827	23,067	–	90,894
Funds held in trust by others	–	2,831,893	–	2,831,893
	<u>\$ 7,515,486</u>	<u>\$ 3,527,635</u>	<u>\$ –</u>	<u>\$ 11,043,121</u>
<b>Liabilities</b>				
Interest rate swap agreements	\$ –	\$ 4,387,733	\$ –	\$ 4,387,733

The amounts reported in the preceding table do not include alternative investments totaling \$10,703 as of September 30, 2012, that were accounted for under the equity method of accounting.

Financial assets carried at fair value included in the pension plan are held in an HHC master trust. The Hospital owns participant units in the trust. Financial assets classified within the trust are 53.4% for Level 1, 34.4% for Level 2, and 12.2% for Level 3 as of September 30, 2013, and 43.3% for Level 1, 45.4% for Level 2, and 11.3% for Level 3 as of September 30, 2012.

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. The interest rate swap agreements are valued based on a determination of market expectations relating to the future cash flows associated with the swap contract using sophisticated modeling based on observable market-based inputs, such as interest rate curves.

# Windham Community Memorial Hospital, Inc., and Affiliates

## Notes to Combined Financial Statements (continued)

### 5. Fair Values of Financial Instruments (continued)

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

### 6. Property, Plant, and Equipment

Property, plant, and equipment consist of the following at September 30:

	<u>2013</u>	<u>2012</u>
Land and land improvements	\$ 5,574,820	\$ 5,258,997
Buildings and building improvements	58,711,867	47,562,746
Equipment	53,688,385	51,579,545
	<u>117,975,072</u>	<u>104,401,288</u>
Less accumulated depreciation	74,173,393	70,034,957
	<u>43,801,679</u>	<u>34,366,331</u>
Construction-in-process (estimated cost to complete – \$2,000,000)	346,011	5,279,793
	<u>\$ 44,147,690</u>	<u>\$ 39,646,124</u>

The Hospital capitalized interest expense of \$173,650 and \$124,835 for the years ended September 30, 2013 and 2012, respectively.

### 7. Pension and Other Postretirement Benefits

The Hospital has a pension plan that provides for both a contributory and noncontributory defined benefit plan for eligible employees providing for retirement and certain death benefits (the pension plan). Contributions to the pension plan are based on actuarially determined amounts sufficient to meet the benefits to be paid to the plan participants. The assets of the pension plan are available to pay the benefits of eligible employees for participating entities based on their allocated share of assets. The service cost component of net periodic pension cost and all other components are actuarially determined as defined by the pension plan.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**7. Pension and Other Postretirement Benefits (continued)**

The benefits are based on years of service and the employees' compensation during the last five years of employment. The Hospital makes contributions in amounts sufficient to fund the pension plan's current service cost, and funding policy is to contribute amounts to these plans sufficient to meet the minimum funding requirements set forth by federal government regulations.

Effective January 1, 2004, Windham began sponsoring the Windham Community Memorial Hospital 401(k) Plan (Defined Contribution Plan). Under the terms of the plan, eligible employees receive a basic contribution of 2%, and the Hospital matches 50% of the employee's salary contribution up to an additional 3% of the employee's compensation. Effective April 1, 2006, all non-union employees hired prior to April 1, 2004, have ceased their participation in the defined benefit plan, and their pension accruals have been frozen as of that date. A second defined contribution plan known as the Windham Hospital Defined Contribution Plan was established for non-union employees hired prior to April 1, 2004. Under the terms of the plan, eligible employees receive a basic contribution of 5% with no matching contribution. Effective January 1, 2010, all non-union employees in the 401(k) plan were transferred into the Defined Contribution Plan. Expense for employer contributions was approximately \$1,937,000 and \$1,851,000 in 2013 and 2012, respectively.

Effective July 1, 2013, Windham amended the postretirement welfare plan to reduce the employer subsidy of the new post-65 coverage offering. Eligible employees are offered a choice between a group Medicare Advantage plan with prescription drug coverage and a Supplemental Retiree Medical Plan with prescription drug coverage.

Included in unrestricted net assets at September 30 are the following amounts that have not yet been recognized in net periodic benefit cost:

	<b>Pension Benefits</b>		<b>Other Postretirement Benefits</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Unrecognized actuarial loss	<b>\$ 35,694,252</b>	\$ 55,061,376	<b>\$ 11,066,651</b>	\$ 14,162,198
Unrecognized prior service credit	-	-	<b>(12,368,236)</b>	(445,777)
	<b>\$ 35,694,252</b>	\$ 55,061,376	<b>\$ (1,301,585)</b>	\$ 13,716,421

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**7. Pension and Other Postretirement Benefits (continued)**

The actuarial loss and prior service credit included in unrestricted net assets at September 30, 2013, and expected to be recognized in net periodic benefit cost during the fiscal year ending September 30, 2014, are as follows:

Unrecognized actuarial loss	\$ (2,148,208)
Unrecognized prior service credit	1,622,815
	<u>\$ (525,393)</u>

The following table sets forth the plans funded status and amounts recognized in the combined balance sheets:

	<b>Pension Benefits</b>		<b>Other Postretirement Benefits</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year	\$ (116,044,600)	\$ (97,664,397)	\$ (32,720,084)	\$ (29,877,981)
Service cost	(275,000)	(275,000)	(83,418)	(92,677)
Interest cost	(4,693,968)	(5,055,459)	(1,045,845)	(1,498,044)
Participant contributions	-	-	(114,089)	(133,843)
Benefits paid	4,160,159	3,536,038	1,671,301	1,585,550
Plan amendments	-	-	13,032,024	-
Medicare part D adjustments	-	-	(68,000)	(83,000)
Actuarial gain (loss)	12,741,282	(16,585,782)	1,658,391	(2,620,089)
Benefit obligation at end of year	<u>(104,112,127)</u>	<u>(116,044,600)</u>	<u>(17,669,720)</u>	<u>(32,720,084)</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	79,084,118	66,070,305	-	-
Actual return on plan assets	10,876,300	10,969,851	-	-
Employer contribution	4,634,000	5,580,000	1,557,212	1,451,707
Participant contribution	-	-	114,089	133,843
Benefits paid	(4,160,159)	(3,536,038)	(1,671,301)	(1,585,550)
Fair value of plan assets at end of year	<u>90,434,259</u>	<u>79,084,118</u>	<u>-</u>	<u>-</u>
Underfunded status	<u>\$ (13,677,868)</u>	<u>\$ (36,960,482)</u>	<u>\$ (17,669,720)</u>	<u>\$ (32,720,084)</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**7. Pension and Other Postretirement Benefits (continued)**

	Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012
Components of net periodic benefit cost				
Service cost	\$ 275,000	\$ 275,000	\$ 83,418	\$ 92,677
Interest cost	4,693,968	5,055,459	1,045,845	1,498,044
Expected return on plan assets	(5,833,357)	(5,263,220)	–	–
Net amortization and deferral	1,582,899	1,268,831	274,333	741,807
Benefit cost included in the statements of operations and changes in net assets	<u>\$ 718,510</u>	<u>\$ 1,336,070</u>	<u>\$ 1,403,596</u>	<u>\$ 2,332,528</u>

The accumulated benefit obligation for the plans was \$121,781,847 and \$148,764,684 as of September 30, 2013 and 2012, respectively.

The weighted-average assumptions used to develop net periodic benefit cost and the projected benefit obligation were as follows:

	Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012
Discount rate for determining benefit obligation at year-end	5.00%	4.10%	4.70%	3.90%
Rate of compensation increase	N/A	N/A	N/A	N/A
Discount rate for net periodic benefit cost	4.10%	5.25%	3.85–3.90%	5.10%
Expected rate of return on plan assets	7.50%	8.00%	–	–

The expected rate of return on assets was determined using the expected return on each asset class based on a model that considers historical and expected future performance.

Assumed health care cost trend rates for 2013 are as follows:

Health care trend rate assumed for next year	8.00%
Rate to which the cost rate trend rate is assumed to decline (the ultimate trend rate)	5.00%
Year that the rate reaches the ultimate trend rate	2018

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**7. Pension and Other Postretirement Benefits (continued)**

A one-percentage-point change in assumed health care cost trend rates would have the following effects on the postretirement benefit plan:

	<b>One-Percentage-Point</b>	
	<b>Increase</b>	<b>Decrease</b>
Effect on total of service and interest cost components	\$ 129,446	\$ (109,286)
Effect on postretirement benefit obligation	\$ 1,784,633	\$ (1,532,769)

**Plan Assets**

The Hospital's pension plan weighted-average asset allocations at September 30, by asset category, are as follows:

<b>Asset Category</b>	<b>Target Allocation</b>	<b>2013</b>	<b>2012</b>
Equity securities	<b>57%</b>	<b>60%</b>	41%
Fixed income/debt securities	<b>25</b>	<b>24</b>	14
Commodities/inflation/real assets	<b>8</b>	<b>6</b>	34
Other	<b>10</b>	<b>10</b>	11
Total	<b>100%</b>	<b>100%</b>	100%

The goals of the plan are to provide a secure retirement benefit for plan participants and to manage pension plan assets for the exclusive benefit of the participants. The Investment Committee of the Board of Directors is responsible for developing, reviewing, and monitoring the investment policy. The plan's assets are invested in accordance with the policy.

**Contributions**

The Hospital expects to make contributions of approximately \$8,000,000 in fiscal year 2014 to its pension plan. The Hospital funds its other postretirement plan for actual expenses incurred.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**7. Pension and Other Postretirement Benefits (continued)**

**Estimated Future Benefit Payments**

Future benefit payments are expected to be paid as follows:

	<b>Pension Benefits</b>	<b>Other Postretirement Benefits</b>
Fiscal Year:		
2014	\$ 4,081,796	\$ 1,008,330
2015	4,385,625	1,072,503
2016	4,678,740	1,124,579
2017	5,040,666	1,184,597
2018	5,461,998	1,251,443
Years 2019–2023	32,102,422	6,500,823

**8. Long-Term Debt**

Details of long-term debt are as follows:

	<b>2013</b>	<b>2012</b>
Intercompany debt with HHC:		
Series A, consisting of a tax-exempt serial bond and term bonds; interest at rates ranging from 4.4% to 5.0%	<b>\$ 18,689,808</b>	\$ 18,740,776
Revolving line of credit, variable rate at 0.92%	<b>15,355,981</b>	11,156,896
Promissory mortgage note with a bank bearing interest at 6%, payments are due in equal installments through Authority: Series, A, B, A-1 and B-1 November 1, 2032, secured by a mortgage on the related real property	<b>269,478</b>	276,239
Capital lease obligations	<b>422,103</b>	231,199
Premium on bonds	<b>358,678</b>	366,062
	<b>35,096,048</b>	30,771,172
Less current portion	<b>(15,740,918)</b>	(11,337,796)
	<b>\$ 19,355,130</b>	\$ 19,433,376

## Windham Community Memorial Hospital, Inc., and Affiliates

### Notes to Combined Financial Statements (continued)

#### **8. Long-Term Debt (continued)**

On September 29, 2011, HHC issued approximately \$375,815,000 of CHEFA Revenue Bonds Series A, B, and C (the HHC 2011 Bonds). In conjunction with the issuance of the HHC 2011 Bonds, an obligated group was formed. The members of the obligated group are HHC, Hartford Hospital, The Hospital of Central Connecticut at New Britain General and Bradley Memorial, Windham Community Memorial Hospital, and MidState Medical Center (collectively referred to as the Obligated Group). Obligated Group members are jointly and severally liable under a Master Trust Indenture (MTI) to make all payments required with respect to obligations under the MTI. HHC does have the right to name designated affiliates, although presently none exist. Though designated affiliates are not obligated to make debt service payments on the obligations under the MTI, each designated affiliate has an independent designated affiliate agreement and promissory note with HHC with stipulated repayment terms and conditions, each subject to the governing law of the Obligated Groups' state of incorporation. In addition, HHC may cause each designated affiliate to transfer such amounts as necessary to enable the Obligated Group members to comply with the terms of the MTI, including payment of the outstanding obligations.

The HHC 2011 Bonds were issued to refund portions of existing debt under HHC and to obtain funds for future capital needs. As such, the HHC 2011 Bonds are reflected as intercompany debt in the preceding schedule. The Hospital is party to the HHC Series A Revenue Bonds. The HHC Series A Revenue Bonds consist of serial bonds that mature annually from July 1, 2014 through July 1, 2023, and the term bonds mature from July 1, 2024 through July 1, 2041. During 2013, the Hospital made advance payments of \$50,968 to HHC for the bonds maturing in 2014.

The MTI and Supplemental MTI provide for the potential establishment and maintenance of a debt service reserve fund, a pledge of gross receipts, as defined, and parity with the HHC Series A Revenue Bonds that remain outstanding. The MTI and loan agreements establish certain restrictive covenants, including a debt service coverage ratio and days cash on hand requirement. No violations of covenants existed as of or for the fiscal years ended September 30, 2013 or 2012.

The fair value of the HHC 2011 Bonds was approximately \$377,885,000 and \$396,836,000 at September 30, 2013 and 2012, respectively. The carrying value of the HHC 2011 Bonds was \$375,815,000 as of September 30, 2013 and 2012. The fair value of the HHC 2011 Bonds was determined by HHC's investment advisor using a market approach that uses prices and other relevant information generated by market transactions involving identical or comparable liabilities and categorized as Level 2 in the fair value hierarchy described in Note 5. The carrying value of the Hospital's other long-term debt approximates fair value at September 30, 2013 and 2012.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**8. Long-Term Debt (continued)**

In conjunction with a debt instrument that has subsequently been terminated, the Hospital entered into two interest rate swap agreements with a financial institution, with an original notional amount of \$19,745,000. The fair value of the swap agreements were \$2,701,010 and \$4,387,733 at September 30, 2013 and 2012, respectively. The change in fair market value of these agreements are reported in the accompanying combined statements of operations and changes in net assets as a component of other non-operating income along with the net cash receipts on the swap agreements.

As part of the HHC 2011 Bonds, the Obligated Group entered into a new line of credit for \$20,000,000 from Bank of America. The line expires in March 2014. As of September 30, 2013 and 2012, the Hospital had not drawn on this line of credit. In 2012, the Obligated Group obtained an additional \$60,000,000 line of credit with another bank. In August 2013, the Obligated Group entered into an amendment increasing this line of credit to \$100,000,000. As of September 30, 2013 and 2012, the Hospital had drawn \$15,355,981 and \$11,156,896, respectively, on this line of credit, which is included in current portion of long-term debt. The rate on the line of credit is variable at 0.92% and it expires in March 2014.

Principal payments due on long-term debt are as follows:

	<b>Long-Term Debt</b>	<b>Capital Leases</b>
Fiscal year ending September 30:		
2014	\$ 15,516,296	\$ 224,622
2015	238,515	165,216
2016	284,246	26,086
2017	306,096	6,179
2018	339,015	-
Thereafter	17,631,099	-
	<u>\$ 34,315,267</u>	<u>\$ 422,103</u>

Interest paid for the fiscal years ended September 30, 2013 and 2012, was \$1,052,132 and \$1,261,044, respectively.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**9. Pledges Receivable**

Pledges receivable included in assets whose use is limited and other assets, include the following unconditional promises to give as of September 30:

	<u>2013</u>	<u>2012</u>
Within one year	\$ 173,543	\$ 340,721
Less allowance	(25,760)	(25,760)
Net pledges receivable	<u>\$ 147,783</u>	<u>\$ 314,961</u>

The allowance recognizes the estimated uncollectible portion of the pledges.

**10. Commitments and Contingencies**

Various lawsuits and claims arising in the normal course of operations are pending or are in progress against the Hospital. Such lawsuits and claims are either specifically covered by insurance as explained in Note 1 or are deemed to be immaterial. While the outcomes of the lawsuits cannot be determined at this time, management believes that any loss that may arise from these actions will not have a material adverse effect on the financial position or changes in net assets of the Hospital.

At September 30, 2013, approximately 77% of employees are covered by various collective bargaining agreements. All of those bargaining agreements are either under negotiations currently or will be within the upcoming year.

The Hospital has several operating lease agreements for certain real estate, medical equipment, and computer equipment. Certain of these leases have renewal options for periods up to five years and escalation clauses. Rent is payable in equal monthly installments. Rent expense was \$1,049,240 and \$782,319 for the years ended September 30, 2013 and 2012, respectively.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**10. Commitments and Contingencies (continued)**

The future minimum lease payments are as follows:

	<u>Amount</u>
2014	\$ 577,682
2015	481,421
2016	425,623
2017	427,079
2018	433,472
Thereafter	1,293,339
	<u>\$ 3,638,562</u>

**11. Related-Party Transactions**

The Hospital obtains services from various HHC affiliates that are recorded at cost that represent an allocation of shared expenditures. Services provided by affiliates for the fiscal years ended September 30, 2013 and 2012, were approximately \$5,930,000 and \$2,860,000.

Amounts due from affiliates related to these services as of September 30 are as follows:

	<u>2013</u>	<u>2012</u>
Due from Hartford HealthCare Medical Group	\$ 247,681	\$ -
Due from Clinical Laboratory Partners	339,574	-
Due from Foundation	460,163	3,066
	<u>\$ 1,047,418</u>	<u>\$ 3,066</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**11. Related-Party Transactions (continued)**

Amounts due to affiliates related to these services as of September 30 are as follows:

	<u>2013</u>	<u>2012</u>
Due to HHC	\$ (1,133,437)	\$ (2,845,310)
Due to Natchaug	(735)	—
	<u>\$ (1,134,172)</u>	<u>\$ (2,845,310)</u>

**12. Functional Expenses**

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

	<u>2013</u>	<u>2012</u>
Health care services	\$ 50,753,686	\$ 52,841,856
Support services	40,614,232	40,486,076
	<u>\$ 91,367,918</u>	<u>\$ 93,327,932</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

**13. Supplemental Cash Flow Information**

The changes in assets and liabilities are as follows:

	<b>Year Ended September 30</b>	
	<b>2013</b>	<b>2012</b>
Decrease (increase) in assets:		
Accounts receivable	\$ 4,701,274	\$ (8,910,759)
Other receivables	(640,683)	(3,336,402)
Due from affiliates	(1,044,352)	-
Inventories of supplies and prepaid expenses	26,703	589,838
Other assets	632,562	(1,123,656)
(Decrease) increase in liabilities:		
Accounts payable	(3,916,885)	1,492,370
Salaries, wages, payroll taxes, and amounts withheld from employees	199,278	14,033
Accrued expenses	49,196	2,710,905
Due to affiliates	1,017,204	2,842,244
Third-party payor settlements	(158,932)	1,427,721
Accrued pension liability	(3,752,965)	(3,115,149)
Other liabilities	5,967,843	1,036,975
	<u>\$ 3,080,243</u>	<u>\$ (6,371,880)</u>

**14. Subsequent Events**

The Hospital evaluated subsequent events through January 31, 2014, which is the date the combined financial statements were issued, for potential recognition in the combined financial statements as of balance sheet date for the fiscal year ended September 30, 2013.

No events occurred that require disclosure or adjustment to the combined financial statements.

## Supplementary Information

# Windham Community Memorial Hospital, Inc., and Affiliates

## Combining Balance Sheets

	September 30, 2013					September 30, 2012
	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	Combined
<b>Assets</b>						
Current assets:						
Cash and cash equivalents	\$ 7,021,350	\$ 13,488	\$ 540,887	\$ –	\$ 7,575,725	\$ 4,122,969
Accounts receivable, less allowance for doubtful accounts of approximately \$3,800,000	11,889,554	–	–	–	11,889,554	20,670,040
Other receivables	4,121,183	–	–	(7,944)	4,113,239	4,081,376
Due from affiliates	1,047,418	–	–	–	1,047,418	3,066
Inventories of supplies	1,150,602	–	–	–	1,150,602	1,105,978
Prepaid expenses and other assets	316,514	–	74,708	–	391,222	462,549
Current portion of assets whose use is limited	551,749	9,089	–	–	560,838	654,986
Total current assets	26,098,370	22,577	615,595	(7,944)	26,728,598	31,100,964
Assets whose use is limited:						
Interest in investments held by Endowment LLC	72,341	–	–	–	72,341	–
Investments and other assets	–	378,132	–	–	378,132	406,468
Donor-restricted interest in investments held by Endowment LLC	1,833,758	–	–	–	1,833,758	–
Investments for restricted purposes	43,868	39,202	–	–	83,070	1,597,574
Funds designated for debt service	1,439,934	–	–	–	1,439,934	1,439,934
	3,389,901	417,334	–	–	3,807,235	3,443,976
Funds held in trust by others	2,371,175	659,600	–	–	3,030,775	2,831,893
Other assets	2,259,728	–	175,083	–	2,434,811	3,123,242
Property, plant, and equipment, net	44,147,686	4	–	–	44,147,690	39,646,124
Total assets	\$ 78,266,860	\$ 1,099,515	\$ 790,678	\$ (7,944)	\$ 80,149,109	\$ 80,146,199

Windham Community Memorial Hospital, Inc., and Affiliates

Combining Balance Sheets (continued)

	September 30, 2013						September 30, 2012
	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	Combined	Combined
<b>Liabilities and net assets</b>							
Current liabilities:							
Accounts payable	\$ 3,395,894	\$ –	\$ 11,125	\$ (7,944)	\$ 3,399,075	\$ 7,315,960	
Salaries, wages, payroll taxes, and amounts withheld from employees	2,012,866	–	–	–	2,012,866	1,813,588	
Accrued expenses	1,114,233	10,800	–	–	1,125,033	1,075,837	
Due to affiliates	1,134,172	–	–	–	1,134,172	2,845,310	
Third-party payor settlements	1,340,072	–	–	–	1,340,072	1,499,004	
Current portion of long-term debt and capital leases	15,740,918	–	–	–	15,740,918	11,337,796	
Current portion of accrued pension liability	5,090,126	–	–	–	5,090,126	5,125,668	
Total current liabilities	29,828,281	10,800	11,125	(7,944)	29,842,262	31,013,163	
Long-term debt	19,355,130	–	–	–	19,355,130	19,433,376	
Accrued pension liability	26,560,346	–	–	–	26,560,346	64,662,899	
Interest rate swap obligation	2,701,010	–	–	–	2,701,010	4,387,733	
Other liabilities	9,139,818	–	–	–	9,139,818	3,171,975	
Total liabilities	87,584,585	10,800	11,125	(7,944)	87,598,566	122,669,146	
Net assets:							
Unrestricted	(14,071,036)	391,628	249,359	–	(13,430,049)	(47,943,489)	
Temporarily restricted	1,218,970	37,487	530,194	–	1,786,651	1,453,029	
Permanently restricted	3,534,341	659,600	–	–	4,193,941	3,967,513	
	(9,317,725)	1,088,715	779,553	–	(7,449,457)	(42,522,947)	
Total liabilities and net assets	\$ 78,266,860	\$ 1,099,515	\$ 790,678	\$ (7,944)	\$ 80,149,109	\$ 80,146,199	

Windham Community Memorial Hospital, Inc., and Affiliates  
Combining Statements of Operations and Changes in Net Assets

	Year Ended September 30, 2013					Year Ended September 30, 2012 Combined
	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	
Unrestricted revenues, gains, and other support:						
Net patient service revenue	\$ 78,210,667	\$ 2,583,034	\$ -	\$ -	\$ 80,793,701	\$ 90,160,381
Provision for bad debts	3,948,677	130,535			4,079,212	3,122,185
Net patient service revenue less provision for bad debts	74,261,990	2,452,499	-	-	76,714,489	87,038,196
Other operating revenue	5,395,488	294,758	-	-	5,690,246	5,420,274
Net assets released from restrictions for operations	163,677	-	12,187	-	175,864	341,424
	79,821,155	2,747,257	12,187	-	82,580,599	92,799,894
Operating expenses:						
Salaries and wages	40,325,328	1,333,069	71,965	-	41,730,362	42,907,325
Employee benefits	12,236,584	404,515	25,765	-	12,666,864	15,336,446
Supplies and other	16,620,559	549,440	32,794	-	17,202,793	17,578,072
Purchased services	13,429,326	443,945	22,990	-	13,896,261	11,316,349
Depreciation and amortization	4,021,991	132,958	-	-	4,154,949	4,147,105
Provision for nonpatient bad debts	583,268	19,282	6,270	-	608,820	717,092
Interest	1,072,417	35,452	-	-	1,107,869	1,325,543
	88,289,473	2,918,661	159,784	-	91,367,918	93,327,932
Operating loss	(8,468,318)	(171,404)	(147,597)	-	(8,787,319)	(528,038)
Loss transferred to Windham	(171,404)	171,404	-	-	-	-
Nonoperating income (loss):						
Income from investments, gifts, and bequests, net	151,502	41,389	305,243	-	498,134	756,073
Other	1,087,479	(16,838)	-	-	1,070,641	(941,371)
	1,238,981	24,551	305,243	-	1,568,775	(185,298)
(Deficiency) excess of revenues over expenses	(7,400,741)	24,551	157,646	-	(7,218,544)	(713,336)

## Windham Community Memorial Hospital, Inc., and Affiliates

### Combining Statements of Operations and Changes in Net Assets (continued)

	Year Ended September 30, 2013					Year Ended September 30, 2012 Combined
	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	
Unrestricted net assets:						
(Deficiency) excess of revenues over expenses	\$ (7,400,741)	\$ 24,551	\$ 157,646	\$ –	\$ (7,218,544)	\$ (713,336)
Net assets released from restriction for purchase of property and equipment	–	17,314	4,888	–	22,202	71,939
Change in pension funding and postretirement obligations	34,385,130	–	–	–	34,385,130	(11,323,642)
Transfer from Hartford HealthCare	7,324,652	–	–	–	7,324,652	–
Transfer from temporarily restricted net assets	–	–	–	–	–	–
Transfer from (to) Foundation	199,393	–	(199,393)	–	–	–
Increase (decrease) in unrestricted net assets	<u>34,508,434</u>	<u>41,865</u>	<u>(36,859)</u>	<u>–</u>	<u>34,513,440</u>	<u>(11,965,039)</u>
Temporarily restricted net assets:						
Restricted contributions	–	–	325,222	–	325,222	301,983
Restricted investment income	1,081	21,134	–	–	22,215	67,771
Return on interest in investments held by Endowment LLC	184,251	–	–	–	184,251	–
Change in unrealized gains on investments	–	–	–	–	–	178,102
Net assets released from restriction for operations	–	–	(175,864)	–	(175,864)	(341,424)
Net assets released from restriction for purchase of property and equipment	–	(17,314)	(4,888)	–	(22,202)	(71,939)
Increase in temporarily restricted net assets	<u>185,332</u>	<u>3,820</u>	<u>144,470</u>	<u>–</u>	<u>333,622</u>	<u>134,493</u>
Permanently restricted net assets:						
Restricted contributions	4,662	–	–	–	4,662	4,200
Restricted investment income	7,464	–	–	–	7,464	26,473
Return on interest in investments held by Endowment LLC	15,420	–	–	–	15,420	–
Change in unrealized gains and losses of funds held in trust	128,558	70,324	–	–	198,882	326,499
Increase in permanently restricted net assets	<u>156,104</u>	<u>70,324</u>	<u>–</u>	<u>–</u>	<u>226,428</u>	<u>357,172</u>
Increase (decrease) in net assets	<u>34,849,870</u>	<u>116,009</u>	<u>107,611</u>	<u>–</u>	<u>35,073,490</u>	<u>(11,473,374)</u>
Net assets at beginning of year	<u>(44,167,595)</u>	<u>972,706</u>	<u>671,942</u>	<u>–</u>	<u>(42,522,947)</u>	<u>(31,049,573)</u>
Net assets at end of year	<u>\$ (9,317,725)</u>	<u>\$ 1,088,715</u>	<u>\$ 779,553</u>	<u>\$ –</u>	<u>\$ (7,449,457)</u>	<u>\$ (42,522,947)</u>

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