

Lawrence + Memorial Hospital
Consolidated Financial Statements and
Supplemental Information
September 30, 2014 and 2013

Lawrence + Memorial Hospital
Index
September 30, 2014 and 2013

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Report of Independent Auditors

To the Board of Trustees of
Lawrence + Memorial Hospital

We have audited the accompanying consolidated financial statements of Lawrence + Memorial Hospital (a subsidiary of Lawrence + Memorial Corporation, the "Hospital"), which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital at September 30, 2014 and September 30, 2013, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual organizations and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and cash flows of the individual organizations.

PricewaterhouseCoopers LLP

January 23, 2015

Lawrence + Memorial Hospital
Consolidated Balance Sheets
September 30, 2014 and 2013

| | 2014 | 2013 |
|--|----------------|----------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 6,917,676 | \$ 418,968 |
| Investments | 128,450,331 | 130,950,162 |
| Patient accounts receivable, net of allowance for doubtful accounts of \$6,293,473 and \$5,068,102, respectively | 36,373,069 | 33,903,908 |
| Other receivables | 4,156,260 | 3,977,343 |
| Inventories | 6,580,753 | 5,845,470 |
| Due from affiliates | 1,954,838 | 1,316,775 |
| Prepaid expenses and other current assets | 2,689,506 | 2,256,097 |
| Debt service fund | 1,304,562 | 1,306,255 |
| Total current assets | 188,426,995 | 179,974,978 |
| Assets limited as to use | | |
| Cash | 182,862 | 182,366 |
| Construction fund | 561,676 | 9,541,685 |
| Investments held in trust | 925,227 | 985,034 |
| Endowment investments | 18,987,367 | 17,922,954 |
| Funds held in trust by others | 6,985,614 | 6,773,578 |
| Contributions receivable | 20,366 | 20,366 |
| Funds held in escrow by agreement with State of Connecticut Health and Educational Facilities Authority and trustees | - | 2,247,255 |
| Total assets limited as to use | 27,663,112 | 37,673,238 |
| Deferred financing costs and other assets, net | 2,315,752 | 1,776,176 |
| Other receivables | 16,536,719 | 13,694,110 |
| Property, plant and equipment, net | 160,857,796 | 161,990,209 |
| | \$ 395,800,374 | \$ 395,108,711 |
| Liabilities and Net Assets | | |
| Current liabilities | | |
| Accounts payable | \$ 25,786,034 | \$ 24,079,687 |
| Accrued vacation and sick pay | 11,281,701 | 11,523,272 |
| Salaries, wages, payroll taxes and amounts withheld from employees | 5,950,567 | 4,495,457 |
| Due to affiliates | 2,215,430 | 1,867,732 |
| Due to third party payors | 5,165,225 | 3,826,094 |
| Current portion of long-term debt | 5,342,305 | 4,487,234 |
| Total current liabilities | 55,741,262 | 50,279,476 |
| Accrued pension and other postretirement benefits | 43,216,010 | 42,309,345 |
| Other liabilities | 20,601,530 | 17,774,823 |
| Long-term debt, less current portion | 108,587,802 | 86,439,477 |
| Total liabilities | 228,146,604 | 196,803,121 |
| Net assets | | |
| Unrestricted | 138,173,767 | 170,160,088 |
| Temporarily restricted | 23,432,028 | 22,198,248 |
| Permanently restricted | 6,047,975 | 5,947,254 |
| Total net assets | 167,653,770 | 198,305,590 |
| | \$ 395,800,374 | \$ 395,108,711 |

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

Lawrence + Memorial Hospital
Consolidated Statements of Operations
Years Ended September 30, 2014 and 2013

| | 2014 | 2013 |
|---|------------------------|----------------------|
| Unrestricted revenues, gains and other support | | |
| Net revenues from services to patients | \$ 337,129,192 | \$ 315,384,106 |
| Provision for bad debt | <u>(14,930,302)</u> | <u>(12,127,746)</u> |
| Net revenue less provision for bad debt | 322,198,890 | 303,256,360 |
| Other operating revenues | 28,151,061 | 19,592,810 |
| Net assets released from restriction used for operations | <u>671,797</u> | <u>508,227</u> |
| Total unrestricted revenues, gains and other support | <u>351,021,748</u> | <u>323,357,397</u> |
| Expenses | | |
| Salaries and wages | 143,838,674 | 149,825,846 |
| Employee benefits | 51,044,718 | 43,535,428 |
| Supplies | 59,538,141 | 45,171,409 |
| Purchased services | 38,647,767 | 23,622,138 |
| Other | 34,490,156 | 33,252,775 |
| Interest | 3,542,721 | 2,705,025 |
| Depreciation and amortization | <u>22,728,484</u> | <u>20,641,159</u> |
| Total expenses | <u>353,830,661</u> | <u>318,753,780</u> |
| (Loss)/income from operations | <u>(2,808,913)</u> | <u>4,603,617</u> |
| Nonoperating gains | | |
| Unrestricted investment income | 180,488 | 122,109 |
| Income from investments | <u>8,608,113</u> | <u>6,041,461</u> |
| Total nonoperating gains | <u>8,788,601</u> | <u>6,163,570</u> |
| Excess of revenues over expenses | 5,979,688 | 10,767,187 |
| Transfers (to)/from affiliated entity | (33,861,262) | 1,136,545 |
| Net unrealized gains on investments | 31,059 | 9,113,432 |
| Net assets released from restriction used for purchase of property, plant and equipment | 139,360 | 167,751 |
| Donated equipment | 6,350 | - |
| Pension related changes other than periodic pension costs | <u>(4,281,516)</u> | <u>5,929,845</u> |
| (Decrease)/increase in unrestricted net assets | <u>\$ (31,986,321)</u> | <u>\$ 27,114,760</u> |

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

Lawrence + Memorial Hospital
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2014 and 2013

| | 2014 | 2013 |
|---|------------------------|-----------------------|
| Unrestricted net assets | | |
| Excess of revenues over expenses | \$ 5,979,688 | \$ 10,767,187 |
| Transfer (to)/from affiliated entities | (33,861,262) | 1,136,545 |
| Net unrealized gains on investment | 31,059 | 9,113,432 |
| Net assets released from restriction used for purchase of property, plant and equipment | 139,360 | 167,751 |
| Donated equipment | 6,350 | - |
| Pension related changes other than periodic pension costs | <u>(4,281,516)</u> | <u>5,929,845</u> |
| (Decrease)/increase in unrestricted net assets | (31,986,321) | 27,114,760 |
| Unrestricted net assets | | |
| Beginning of year | <u>170,160,088</u> | <u>143,045,328</u> |
| End of year | <u>\$ 138,173,767</u> | <u>\$ 170,160,088</u> |
| Temporarily restricted net assets | | |
| Income from investments | \$ 614,481 | \$ 643,386 |
| Net assets released from restriction | (811,157) | (675,978) |
| Contributions received | 222,134 | 235,453 |
| Change in value of irrevocable trust | 111,315 | 239,710 |
| Net realized and unrealized gains on investments | <u>1,097,007</u> | <u>1,663,438</u> |
| Increase in temporarily restricted net assets | 1,233,780 | 2,106,009 |
| Temporarily restricted net assets | | |
| Beginning of year | <u>22,198,248</u> | <u>20,092,239</u> |
| End of year | <u>\$ 23,432,028</u> | <u>\$ 22,198,248</u> |
| Permanently restricted net assets | | |
| Change in value of funds held in trust by others | <u>\$ 100,721</u> | <u>\$ 82,447</u> |
| Increase in permanently restricted net assets | 100,721 | 82,447 |
| Permanently restricted net assets | | |
| Beginning of year | <u>5,947,254</u> | <u>5,864,807</u> |
| End of year | <u>\$ 6,047,975</u> | <u>\$ 5,947,254</u> |
| (Decrease)/increase in net assets | <u>\$ (30,651,820)</u> | <u>\$ 29,303,216</u> |

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

Lawrence + Memorial Hospital
Consolidated Statements of Cash Flows
Years Ended September 30, 2014 and 2013

| | 2014 | 2013 |
|--|---------------------|---------------------|
| Cash flows from operating activities | | |
| Change in net assets | \$ (30,651,820) | \$ 29,303,216 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities | | |
| Depreciation and amortization | 22,728,484 | 20,641,159 |
| Restricted contributions | (725,796) | (883,096) |
| Net unrealized gains on investments | (755,794) | (10,508,881) |
| Provision for bad debts | 14,930,302 | 12,127,746 |
| Increase in funds held in trust by others | (212,036) | (322,158) |
| Changes in other operating accounts | | |
| Patient accounts receivable, net | (17,399,463) | (17,085,061) |
| Other receivables, net | (3,021,526) | (182,723) |
| Inventories | (735,283) | (1,376,000) |
| Due from affiliates | (638,063) | (676,976) |
| Prepaid expenses and other current assets | (433,409) | (251,521) |
| Deferred financing costs and other assets | (539,576) | 81,328 |
| Accounts payable | 1,274,289 | (2,389,268) |
| Accrued vacation and sick pay | (241,571) | (760,658) |
| Salaries, wages, payroll taxes and amounts withheld from employees | 1,455,110 | 607,569 |
| Due to affiliates | 347,698 | (553,512) |
| Due to third party payors | 1,339,131 | (1,583,462) |
| Pension, postretirement and other liabilities | 3,733,372 | (9,100,040) |
| Net cash (used in)/provided by operating activities | <u>(9,545,951)</u> | <u>17,087,662</u> |
| Cash flows from investing activities | | |
| Purchase of property, plant and equipment, net | (21,164,013) | (46,683,245) |
| Purchase of investments | (58,786,901) | (63,030,285) |
| Sales of investments | 70,017,433 | 69,794,029 |
| Decrease in debt service fund | 1,693 | 855 |
| Decrease/(increase) in funds held in escrow | 2,247,255 | (130) |
| Net cash used in investing activities | <u>(7,684,533)</u> | <u>(39,918,776)</u> |
| Cash flows from financing activities | | |
| Restricted contributions | 725,796 | 883,096 |
| Principal payments of long term debt | (27,739,349) | (2,938,881) |
| Proceeds of long term debt | 50,742,745 | 11,596,368 |
| Net cash provided by financing activities | <u>23,729,192</u> | <u>9,540,583</u> |
| Net increase/(decrease) in cash and cash equivalents | 6,498,708 | (13,290,531) |
| Cash and cash equivalents | | |
| Beginning of year | 418,968 | 13,709,499 |
| End of year | <u>\$ 6,917,676</u> | <u>\$ 418,968</u> |
| Supplemental disclosure of noncash activities | | |
| Construction in process included in accounts payable | <u>\$ 1,673,118</u> | <u>\$ 2,105,176</u> |
| Contributed securities | <u>\$ 725,796</u> | <u>\$ 883,096</u> |

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

Lawrence + Memorial Hospital

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

1. Significant Accounting Policies and Organization

Organization

Lawrence + Memorial Hospital (the "Hospital"), a nonprofit organization incorporated under the General Statutes of the State of Connecticut, is a wholly owned subsidiary of Lawrence + Memorial Corporation (the "Corporation"). The Board of the Corporation elects a Board of Directors who manages the property and affairs of the Hospital.

Principles of Consolidation

The consolidated financial statements include the accounts of the Hospital and its wholly owned subsidiary, Associated Specialists of Southeastern Connecticut, Inc. ("Associated Specialists"). All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying footnotes. Actual results could differ from those estimates and there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Hospital's significant estimates include the collectability of patient accounts receivable, useful lives of fixed assets, estimated settlements due to third party payors, valuation of certain investments, estimated reserves for self-insurance liabilities, and benefit plan assumptions.

Regulatory Matters

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

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. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital and its subsidiary in perpetuity or in funds held in trust by others whose purpose is for the funds to be maintained in perpetuity.

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 to unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions in the accompanying consolidated statements of operations.

Cash and Cash Equivalents

The Hospital and its subsidiary consider all highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents.

Lawrence + Memorial Hospital

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Investments

Investments in equity and debt securities are recorded at fair value in the balance sheet. Fair value is generally determined based on quoted market prices where available or net asset values provided by investment managers. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are included in the change in net assets.

Realized and unrealized gains and losses on donor restricted endowment funds are included in temporarily restricted net assets under State law which allows the Board to appropriate as much of the net appreciation of investments as is prudent considering the Hospital's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends and general economic conditions.

Investments in limited liability companies are accounted for using the equity method in instances where the limited partner's interest is more than minor (3-5%).

Fair Value Measurements

Fair value guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entities own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the Hospital for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

- Level 1 – Quoted prices in active markets for identical assets.
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets in active markets, quoted prices in markets that are not active, or can be corroborated by observable market data for substantially the same term of the assets.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets.

Assets Held in Trust by Others

The Hospital has been named sole or participating beneficiary in several perpetual and charitable remainder trusts. Under the terms of these trusts, the Hospital has the irrevocable right to receive the income earned on the trust assets in perpetuity from the perpetual trusts and to receive the remainder of the trust assets for the charitable remainder trusts. For perpetual trusts, the estimated present value of the future payments to the Hospital is recorded at the fair value of the assets held in the trust. The charitable remainder trusts are recorded at the present value of the estimated future distributions expected to be received over the expected term of the trust agreement. The Hospital uses appropriate credit adjusted rates.

Lawrence + Memorial Hospital

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Assets Limited as to Use

Assets limited as to use include assets set aside by the Board of Directors and contribution receivables for the established purpose of providing for future improvement, expansion and replacement of plant and equipment. In addition, the Hospital's interest in externally managed trusts, unexpended bond proceeds for construction purposes, and assets held by trustees under indenture agreements relating to financing activities with the State of Connecticut Health and Education Facilities Authority ("CHEFA") are also included therein.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost, or, if received as a donation, at the fair value on the date received. The Hospital provides for depreciation of property, plant and equipment using the straight-line method in amounts sufficient to amortize the cost of its assets over their useful lives. American Hospital Association lives are generally used and provide for a 2-25 year life for land improvements, 5-50 year life for buildings and 2-25 year life for equipment. Lease improvements are amortized over the life of the lease.

Non operating Gains and Losses

Activities other than in connection with providing health care services are considered to be non operating.

Excess of Revenues Over Expenses

The consolidated statement of operations includes excess of revenues over expenses. Changes in unrestricted net assets which are excluded from the excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), and pension-related charges other than periodic pension costs and other postretirement benefits liabilities.

Fair Value of Financial Instruments

Certain investments and other assets and liabilities are carried at amounts that approximate fair value based on current market conditions. The fair value of long-term debt is estimated based on the quoted market prices for the same or similar issues or on current rates offered to the Hospital for debt of the same remaining maturities.

Medical Malpractice Self-Insurance

The Hospital purchases claims made-based professional and general liability insurance to cover medical malpractice claims from L + M Indemnity, Ltd. The Hospital has adopted the policy of self-insuring the tail coverage portion of its malpractice insurance coverage. Management has accrued the estimate of losses anticipated to be incurred.

Income Taxes

The Hospital and its wholly owned subsidiary, Associated Specialists, are not-for-profit organizations and are exempt from federal income taxes on related income under Section 501(c) (3) of the Internal Revenue Code.

Lawrence + Memorial Hospital
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

Inventories

Inventory consists of supplies, both medical and general, pharmaceuticals and food products needed to sustain daily operation of patient care. Inventories are carried at the lower of cost or market under the first-in-first-out (FIFO) method.

Impairment of Long-Lived Assets

Long-lived assets to be held and used are reviewed for impairment whenever circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to dispose.

Accrued Vacation and Sick Pay

Accrued vacation is recorded as a liability as time is earned. As the time is used, the time is relieved from the liability. Accrued sick time is recorded as a percent for employees who have a balance greater than or equal to 800 hours. This payout is only upon termination of employment.

Labor action update

The Hospital's negotiations with two of its three unions, AFT Healthcare, AFT-CT, AFT, AFL-CIO, Local 5049 (registered nurses) and AFT Healthcare, AFT-CT, AFLCIO, Local 5051 (licensed practical nurses and technicians) for a new contract resulted in a 4-day strike that commenced on November 27, 2013. The Hospital brought in temporary replacement workers, and, in order to provide ongoing patient care given the threat of additional, intermittent strikes, had a lockout of employees through December 18, 2013. The lockout was lifted and employees returned to work without a contract being reached. A contract was reached and ratified and the workforce had a three year contract that was signed in February 2014. The Hospital monitored the negative impact of the strike and lockout on both revenues and expenses. The negative financial impact included in the year ended September 30, 2014 is approximately \$14,200,000 (unaudited). This impact consisted of a reduction in net revenue of approximately \$1,900,000 (unaudited) and \$12,300,000 (unaudited) of replacement workers, security and reduced salary costs during the strike and lock out period.

Subsequent Events

The Hospital has performed an evaluation of subsequent events through January 23, 2015, which is the date the financial statements were issued.

2. Revenues from Services to Patients and Charity Care

The following summarizes net revenues from services to patients:

| | 2014 | 2013 |
|--|-----------------------|-----------------------|
| Gross charges from services to patients | \$ 795,287,303 | \$ 718,354,285 |
| Less: Charity care | <u>5,449,069</u> | <u>7,125,259</u> |
| Charges from services to patients, net of charity care | <u>789,838,234</u> | <u>711,229,026</u> |
| Deductions | | |
| Allowances | 450,251,022 | 394,797,284 |
| State of Connecticut uncompensated care system | <u>2,458,020</u> | <u>1,047,636</u> |
| Total deductions | <u>452,709,042</u> | <u>395,844,920</u> |
| Net revenues from services to patients | <u>\$ 337,129,192</u> | <u>\$ 315,384,106</u> |

Lawrence + Memorial Hospital

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Patient accounts receivable and revenues are recorded when patient services are performed. Amounts received from most payors are different from established billing rates of the Corporation, and these differences are accounted for as allowances. The state of Connecticut has reduced Uncompensated Care Payments to all hospitals beginning July 2013 for a three year period. In 2014, the Corporation paid cash into the State of Connecticut Uncompensated Care Pool that exceeded the amount was received from the State.

Net patient service revenue is reported at the estimated net realizable amounts from patients, third party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Adjustments related to prior year settlements decreased the Hospital's revenues by approximately \$1,584,575 in 2014 and increased the Hospital's revenue by approximately \$1,126,576 in 2013.

During 2014 and 2013, approximately 35% and 33%, respectively of net patient service revenue was received under the Medicare program, and 11% and 12%, respectively, under the state Medicaid program. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. 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. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation. Noncompliance could result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and reductions of funding levels could have an adverse impact on the Hospital.

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 federal poverty income guidelines.

Lawrence + Memorial Hospital
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

3. Investments

Investments at September 30 consist of:

| | 2014 | 2013 |
|---|-----------------------|-----------------------|
| Other investments | | |
| Cash and cash equivalents | 2,582,141 | 1,039,729 |
| Bonds | 20,187,600 | 19,613,262 |
| Mutual funds | 54,002,586 | 63,223,755 |
| Hedge funds | 47,442,075 | 45,300,989 |
| Private equities | 4,235,929 | 1,772,427 |
| Total other investments | <u>128,450,331</u> | <u>130,950,162</u> |
| Funds held in trust by others | | |
| Investments held in trust by others | <u>6,985,614</u> | <u>6,773,578</u> |
| Total investments held in trust by others | <u>6,985,614</u> | <u>6,773,578</u> |
| Endowment investments | | |
| Cash and cash equivalents | \$ 255,829 | \$ 201,482 |
| Bonds | 2,481,439 | 2,393,150 |
| Mutual funds | 10,596,174 | 9,977,123 |
| Hedge funds | 4,977,463 | 4,734,703 |
| Private equities | 168,351 | 90,111 |
| Marketable equities | 508,111 | 526,385 |
| Total endowment investments | <u>18,987,367</u> | <u>17,922,954</u> |
| Total Investments at fair value | <u>\$ 154,423,312</u> | <u>\$ 155,646,694</u> |

Lawrence + Memorial Hospital
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

The Hospital's financial instrument categorization is based upon the lowest level of input that is significant to the fair value measurement within the valuation hierarchy. The following table presents the financial instruments carried at fair value using the valuation hierarchy:

| | 2014 | | | Total Fair Value |
|--------------------------------------|----------------------|---------------------|----------------------|-----------------------------|
| | Level 1 | Level 2 | Level 3 | |
| Other investments | | | | |
| Cash and cash equivalents | 2,582,141 | - | - | 2,582,141 |
| Bonds | 14,261,701 | 5,925,899 | - | 20,187,600 |
| Mutual funds | 54,002,586 | - | - | 54,002,586 |
| Hedge funds | - | - | 47,442,075 | 47,442,075 |
| Private equities | - | - | 4,235,929 | 4,235,929 |
| Total other investments | <u>70,846,428</u> | <u>5,925,899</u> | <u>51,678,004</u> | <u>128,450,331</u> |
| Funds Held in trust by others | | | | |
| Investments held in trust by others | - | - | 6,985,614 | 6,985,614 |
| Total held in trust by others | <u>-</u> | <u>-</u> | <u>6,985,614</u> | <u>6,985,614</u> |
| Endowment investments | | | | |
| Cash and cash equivalents | \$ 255,829 | \$ - | \$ - | \$ 255,829 |
| Bonds | 1,560,348 | 608,664 | 312,427 | 2,481,439 |
| Mutual funds | 9,018,452 | - | 1,577,722 | 10,596,174 |
| Hedge funds | - | - | 4,977,463 | 4,977,463 |
| Private equities | - | - | 168,351 | 168,351 |
| Marketable equities | 508,111 | - | - | 508,111 |
| Total endowment investments | <u>11,342,740</u> | <u>608,664</u> | <u>7,035,963</u> | <u>18,987,367</u> |
| | <u>\$ 82,189,168</u> | <u>\$ 6,534,563</u> | <u>\$ 65,699,581</u> | <u>\$ 154,423,312</u> |
| 2013 | | | | |
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Other investments | | | | |
| Cash and cash equivalents | 1,039,729 | - | - | 1,039,729 |
| Bonds | 13,777,897 | 5,835,365 | - | 19,613,262 |
| Mutual funds | 63,223,755 | - | - | 63,223,755 |
| Hedge funds | - | - | 45,300,989 | 45,300,989 |
| Private equities | - | - | 1,772,427 | 1,772,427 |
| Total other investments | <u>78,041,381</u> | <u>5,835,365</u> | <u>47,073,416</u> | <u>130,950,162</u> |
| Funds Held in trust by others | | | | |
| Investments held in trust by others | - | - | 6,773,578 | 6,773,578 |
| Total held in trust by others | <u>-</u> | <u>-</u> | <u>6,773,578</u> | <u>6,773,578</u> |
| Endowment investments | | | | |
| Cash and cash equivalents | \$ 201,482 | \$ - | \$ - | \$ 201,482 |
| Bonds | 1,582,076 | 599,579 | 211,495 | 2,393,150 |
| Mutual funds | 8,529,184 | - | 1,447,939 | 9,977,123 |
| Hedge funds | - | - | 4,734,703 | 4,734,703 |
| Private equities | - | - | 90,111 | 90,111 |
| Marketable equities | 526,385 | - | - | 526,385 |
| Total endowment investments | <u>10,839,127</u> | <u>599,579</u> | <u>6,484,248</u> | <u>17,922,954</u> |
| | <u>\$ 88,880,508</u> | <u>\$ 6,434,944</u> | <u>\$ 60,331,242</u> | <u>\$ 155,646,694</u> |

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Fair value for Level 1 is based upon quoted prices in active markets that the Hospital has the ability to access at the measurement date. Market price data is generally obtained from exchange or dealer markets. The Hospital does not adjust the quoted price for such assets.

Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and 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.

Fair value for Level 3 is based on valuation techniques that use significant inputs that are unobservable as they trade infrequently or not at all and reflect assumptions based on the best information available in the circumstances.

Investments included in Level 3 primarily consist of the Hospital's ownership in alternative investments (principally limited partnership interests in hedge funds). The value of these alternative investments represents the ownership interest in the net asset value ("NAV") of the respective partnership. The fair values of the securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner and are based on appraisals, or other estimates that require varying degrees of judgment. If no public market exists for the investment securities, the fair value is determined by the general partner taking into consideration, among other things, the cost of the securities, prices of recent significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate. Also included in Level 3 investments are charitable remainder trusts held by third parties which are recorded at the present value of the future distributions expected to be received over the term of the agreement.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of 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.

The following table is a roll forward of the amounts by investment type for financial instruments classified by the Hospital within Level 3 of the fair value hierarchy defined above:

| | Beginning October 1, 2013 | Investment Income | Realized Gains | Unrealized Gains | Investment Fees | Purchases | Sales | Ending September 30, 2014 |
|------------------------|---------------------------------|----------------------|-------------------|---------------------|--------------------|--------------|--------------|---------------------------------|
| Investment pool | | | | | | | | |
| Hedge funds | \$ 51,695,126 | \$ 526,509 | \$ 242,582 | \$ 1,907,402 | \$ (133,494) | \$ 339,590 | \$ (268,029) | \$ 54,309,686 |
| Private equities | 1,862,538 | - | 386,731 | 262,436 | (78,224) | 2,047,216 | (76,416) | 4,404,281 |
| Funds held in trust | 6,773,578 | - | - | 212,036 | - | - | - | 6,985,614 |
| Total | \$ 60,331,242 | \$ 526,509 | \$ 629,313 | \$ 2,381,874 | \$ (211,718) | \$ 2,386,806 | \$ (344,445) | \$ 65,699,581 |

| | Beginning October 1, 2012 | Investment Income | Realized Gains | Unrealized Gains | Investment Fees | Purchases | Sales | Ending September 30, 2013 |
|------------------------|---------------------------------|----------------------|-------------------|---------------------|--------------------|--------------|----------------|---------------------------------|
| Investment pool | | | | | | | | |
| Hedge funds | \$ 46,566,786 | \$ 299,208 | \$ 1,025,998 | \$ 4,503,429 | \$ (111,018) | \$ 1,037,784 | \$ (1,627,061) | \$ 51,695,126 |
| Private equities | 428,792 | - | 63,278 | 100,252 | (56,899) | 1,339,123 | (12,008) | 1,862,538 |
| Funds held in trust | 6,451,420 | - | - | 322,158 | - | - | - | 6,773,578 |
| Total | \$ 53,446,998 | \$ 299,208 | \$ 1,089,276 | \$ 4,925,839 | \$ (167,917) | \$ 2,376,907 | \$ (1,639,069) | \$ 60,331,242 |

There were no transfers amongst levels during 2014 or 2013.

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A summary of the pooled endowment investment return is presented below:

| | 2014 | 2013 |
|---------------------------------------|---------------------|---------------------|
| Investment income | \$ 284,499 | \$ 289,540 |
| Realized and unrealized gains | 1,097,815 | 1,663,438 |
| Management fees and other costs | <u>(48,666)</u> | <u>(41,701)</u> |
| Total return on endowment investments | <u>\$ 1,333,648</u> | <u>\$ 1,911,277</u> |

Following is additional information related to funds whose fair value is not readily determinable as of September 30, 2014.

| | Strategy | Fair Value | # of Investments | Remaining Life | \$ Amount of Unfunded Commitments | Timing to Draw Down Commitments | Redemption Terms | Redemption Restrictions | Restrictions in Place at Year End |
|-------------------|--|----------------------|------------------|----------------|-----------------------------------|---------------------------------|--------------------------------|---|-----------------------------------|
| Equity securities | Global developed and emerging market equity | \$ 12,908,765 | 1 | N/A | \$ - | No remaining commitments | Monthly with 10 day's notice | None | None |
| Absolute return | Long/short and long-biased equity and credit hedge funds | 16,694,771 | 7 | N/A | | No remaining commitments | Annual with 90 day's notice | lock up provision of 12 months from the purchase date | None |
| Directional hedge | Long/short and long-biased equity and credit hedge funds | 20,503,544 | 1 | N/A | | No remaining commitments | Quarterly with 60 day's notice | lock up provision of 25 months from the purchase date | None |
| Commodities | Commodity index | 4,202,605 | 1 | N/A | | No remaining commitments | Monthly with 5 day's notice | None | None |
| Private equity | Private equity | 4,404,282 | 5 | N/A | | Illiquid long term 5 years | None | None | None |
| | | <u>\$ 58,713,967</u> | | | | | | | |

4. Endowment

The Hospital's endowment consists of donor restricted endowment funds for a variety of purposes. The net assets associated with endowment funds including funds designated by the Board of Directors to function as endowments are classified and reported based on the existence or absence of donor imposed restrictions.

The Hospital understands net asset classification guidance requires that donor restricted endowment gifts be maintained in perpetuity. Consistent with net asset classification guidance, the Hospital classified as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (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 temporarily restricted net assets until those amounts are appropriated for expenditure. The Hospital considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund.
- The purposes of the Hospital and donor-restricted endowment fund.
- General economic conditions.
- The possible effect of inflation and deflation.
- The expected total return from income and the appreciation of investments.
- Other resources of the Hospital.
- The investment policies of the Hospital.

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Changes in endowment net assets for year ended September 30:

| | 2014 | | | Total |
|--|--------------|------------------------|------------------------|----------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Endowment net assets at beginning of year | \$ - | \$ 15,304,434 | \$ 2,839,683 | \$ 18,144,117 |
| Investment return | | | | |
| Investment income | - | 107,295 | - | 107,295 |
| Net realized and unrealized gains | - | 1,097,006 | - | 1,097,006 |
| Total investment return | - | 1,204,301 | - | 1,204,301 |
| Income distribution | - | (139,360) | - | (139,360) |
| Endowment net assets at end of year | \$ - | \$ 16,369,375 | \$ 2,839,683 | \$ 19,209,058 |

| | 2013 | | | Total |
|--|--------------|------------------------|------------------------|----------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Endowment net assets at beginning of year | \$ - | \$ 13,633,436 | \$ 2,839,683 | \$ 16,473,119 |
| Investment return | | | | |
| Investment income | - | 137,152 | - | 137,152 |
| Net realized and unrealized gains | - | 1,663,438 | - | 1,663,438 |
| Total investment return | - | 1,800,590 | - | 1,800,590 |
| Income distribution | - | (129,592) | - | (129,592) |
| Endowment net assets at end of year | \$ - | \$ 15,304,434 | \$ 2,839,683 | \$ 18,144,117 |

The portion of perpetual endowment funds retained permanently either by explicit donor stipulation or by net asset classification guidance is summarized as follows:

| | 2014 | 2013 |
|---|----------------------|----------------------|
| Temporarily restricted net assets | | |
| Unspent income and appreciation on permanently restricted endowments for purchase of equipment and healthcare services | \$ 16,369,376 | \$ 15,304,434 |
| Total endowment funds classified as temporarily restricted net assets | <u>\$ 16,369,376</u> | <u>\$ 15,304,434</u> |
| Permanently restricted net assets | | |
| Corpus of permanently restricted contributions for which income is to be used for purchase of equipment and healthcare services | \$ 2,839,683 | \$ 2,839,683 |
| Total endowment funds classified as permanently restricted net assets | <u>\$ 2,839,683</u> | <u>\$ 2,839,683</u> |

Endowment Funds with Deficits

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist they are classified as a reduction of unrestricted net assets.

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Endowment Investment Return Objectives and Risk Parameters

The Hospital has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by the endowment while seeking to maintain the permanent nature of endowment funds. Under this policy, the return objective for the endowment assets measured over a full market cycle shall be to maximize the return against a blended index, based on the endowment's target asset allocation applied to the appropriate individual benchmarks.

Strategies Employed for Achieving Endowment Investment Objectives

To achieve 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 gains) and current yield (interest and dividends). The Hospital targets a diversified asset allocation to achieve its long-term objectives within prudent Hospital risk constraints.

Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives

Spending is guided by several factors most important is the value of the portfolio. Generally, the Board will approve a spending policy limiting annual expenditures for grants and operating expenses up to 4.5% of the value of the Funds' assets based on a 12 quarter rolling average for the endowment and operating funds.

Investment managers are given ample notice of the required withdrawal schedule. Appropriate liquidity is maintained to fund these withdrawals without impairing the investment process.

5. Temporarily and Permanently Restricted Net Assets

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

| | 2014 | 2013 |
|---|----------------------|----------------------|
| Funds held in trust by others | \$ 3,799,127 | \$ 3,687,812 |
| Contributions receivable | 20,366 | 20,366 |
| Free beds and plant replacement and expansion | 16,369,376 | 15,304,434 |
| Specific purpose reserves | <u>3,243,159</u> | <u>3,185,636</u> |
| | <u>\$ 23,432,028</u> | <u>\$ 22,198,248</u> |

Permanently restricted net assets at September 30 are restricted to:

| | 2014 | 2013 |
|----------------------------------|---------------------|---------------------|
| Funds held in trust by others | \$ 3,208,292 | \$ 3,107,571 |
| Donor restricted endowment funds | <u>2,839,683</u> | <u>2,839,683</u> |
| | <u>\$ 6,047,975</u> | <u>\$ 5,947,254</u> |

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6. Property, Plant and Equipment

Property, plant and equipment consists of the following:

| | 2014 | 2013 |
|--------------------------------|-----------------------|-----------------------|
| Land and land improvements | \$ 8,846,232 | \$ 7,343,577 |
| Buildings | 150,910,346 | 120,101,634 |
| Equipment | <u>265,024,485</u> | <u>234,099,872</u> |
| | 424,781,063 | 361,545,083 |
| Less: Accumulated depreciation | <u>(265,615,130)</u> | <u>(245,331,839)</u> |
| | 159,165,933 | 116,213,244 |
| Construction in progress | | |
| | <u>1,691,863</u> | <u>45,776,965</u> |
| | <u>\$ 160,857,796</u> | <u>\$ 161,990,209</u> |

7. Long-Term Debt

| | 2014 | 2013 |
|---|-----------------------|----------------------|
| CHEFA Series F Revenue Bonds | | |
| Various rate bonds, due 2015 to 2026 | \$ 30,900,000 | \$ 33,625,000 |
| 5.0% Term Bonds, due 2027 to 2031 | 8,705,000 | 8,705,000 |
| 5.0% Term Bonds, due 2032 to 2036 | 11,100,000 | 11,100,000 |
| CHEFA Series E revenue bonds | | |
| Variable rate bonds, due 2023-2034 | - | 22,990,000 |
| CHEFA Series G revenue bonds | | |
| 3.2% Term Bonds, due 2023, option to extend with a maturity date of 2038 | 29,200,000 | - |
| CHEFA H revenue bonds | | |
| variable rate bonds, due 2023 to 2034 | 21,405,000 | - |
| Tax exempt lease | 9,963,984 | 11,596,368 |
| Capital lease obligation | <u>112,009</u> | <u>250,586</u> |
| Total debt outstanding | 111,385,993 | 88,266,954 |
| Less: Amounts classified as current | 5,342,305 | 4,487,234 |
| Add: Bond premium | <u>2,544,115</u> | <u>2,659,757</u> |
| Total long-term portion of long-term debt | <u>\$ 108,587,803</u> | <u>\$ 86,439,477</u> |

On September 15, 2011 the Connecticut Health and Education Facilities Authority (“CHEFA”) issued \$58,940,000 of Series F Bonds (the “Series F Bonds”) on behalf of the Hospital and Lawrence + Memorial Corporation (collectively referred to as the “Obligated Group” under the Series F Bond agreements). The Series F Bonds are structured with a term bond due July 1, 2036, with annual sinking fund payments due each July 1st. Interest on the Series F Bonds is payable semiannually on the first business day of January 1 and July 1 which began on January 1, 2012.

The Series E bonds were paid early with the issuance of CHEFA series H.

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The tax exempt lease was obtained on June 27, 2013 in the principal amount of \$12,000,000. This is a seven year equipment lease on specific capital purchases that is administered through CHEFA and Bank of America-Merrill Lynch. This lease will be amortized monthly through June 27, 2020 at a nominal annual interest rate of 1.759%.

On October 10, 2013 Series G was issued in a private placement offering with Bank of America-Merrill Lynch and CHEFA in the amount of \$29,200,000 with an interest rate of 3.20% until October 1, 2023 with an option to extend at a negotiated rate with a maturity date of July 1, 2038.

On November 5, 2013, Series H was issued by CHEFA to refinance Series E. Series H was issued in the amount of \$21,405,000 with a variable rate and a maturity date of July 1, 2034. This bond has a letter of credit guaranteed by T.D. Bank. Interest on the Series H Bonds accrues at the weekly rate and is payable on the first business day of each month commencing January 1, 2014.

Under the terms of the trust indenture for the Series H Bonds, the Obligated Group is required to meet certain financial covenants including a debt service coverage ratio and days cash on hand ratio. Members of the Obligated Group are jointly and severally obligated to provide amounts sufficient to enable the Authority to pay principal and interest on the Series H Bonds. The Bonds and bond proceeds have been allocated to the Hospital and as such, the Hospital will make future debt service payments as required under the terms of the bonds.

The bonds may be retired at an earlier date pursuant to terms of the master indenture. Payment of the bonds is collateralized by a pledge of the gross receipts, as defined and certain real property of the Hospital.

The Series H Bonds are considered variable rate demand bonds and are remarketed on a weekly basis. The Hospital maintains a letter of credit in the amount of \$21,405,000 which expires on November 5, 2016. If the bonds are unable to be remarketed, the letter of credit could be utilized to purchase the bonds. The Obligated Group would then be subject to the payment terms of the letter of credit, which are monthly installments. The Series H Bonds have been successfully remarketed in the past and there have been no draws on the letter of credit.

The fair value of the outstanding bonds is \$106,215,296 and \$78,820,117 at September 30, 2014 and September 30, 2013, respectively.

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Principal repayments on the CHEFA bonds are as follows:

| Years | Annual Principal Repayment |
|---------------------|---|
| 2015 | \$ 3,660,000 |
| 2016 | 3,825,000 |
| 2017 | 4,010,000 |
| 2018 | 4,165,000 |
| 2019 and thereafter | <u>85,650,000</u> |
| | <u>\$ 101,310,000</u> |

The Hospital made cash interest payments of \$3,566,051 and \$2,682,472 in fiscal year 2014 and 2013, respectively. No interest was capitalized during 2014 or 2013.

8. Pension and Other Postretirement Benefits

The Hospital has a defined benefit plan covering all employees who elected to stay in the plan. The plan is frozen to new participants as of June 30, 1999. The benefits are based on years of service and the employee's compensation during the last five years of employment

The Hospital provides health care and life insurance benefits to its retired employees who meet certain eligibility requirements. The Hospital's policy is to fund the cost of postretirement benefits other than pension as incurred. This plan was frozen to include only those employees who retired prior to May 1, 1994.

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The following table sets forth the Plans' funded status and amounts recognized in the consolidated balance sheet at September 30, 2014 and 2013 (measurement date of September 30), the significant change in the actuarial loss is predominantly related to the decrease in the discount rate used to determine the benefit obligation at the end of the year:

| | Pension Benefits | | Other Postretirement Benefits | |
|---|-------------------------|-----------------------|--------------------------------------|-----------------------|
| | 2014 | 2013 | 2014 | 2013 |
| Change in benefit obligation | | | | |
| Benefit obligation at beginning of year | \$ 145,789,789 | \$ 147,201,452 | \$ 1,000,744 | \$ 1,289,208 |
| Service cost | 2,402,724 | 1,536,115 | - | - |
| Interest cost | 6,417,121 | 5,685,930 | 29,884 | 31,620 |
| Employee contributions | 69,839 | 90,611 | - | - |
| Benefits paid | (7,015,362) | (6,590,842) | (95,403) | (107,793) |
| Actuarial loss/(gain) | 9,010,698 | (2,133,477) | (97,788) | (212,291) |
| Benefit obligation at end of year | <u>156,674,809</u> | <u>145,789,789</u> | <u>837,437</u> | <u>1,000,744</u> |
| Change in plan assets | | | | |
| Fair value of plan assets at beginning of year | 105,860,348 | 98,298,309 | - | - |
| Actual return on plan assets | 9,861,899 | 7,662,270 | - | - |
| Employee contributions | 69,839 | 90,611 | - | - |
| Employer contributions | 6,400,000 | 6,400,000 | 95,403 | 107,793 |
| Benefits paid | (7,015,362) | (6,590,842) | (95,403) | (107,793) |
| Fair value of plan assets at end of year | <u>115,176,724</u> | <u>105,860,348</u> | <u>-</u> | <u>-</u> |
| Funded status of the plan | (41,498,085) | (39,929,441) | (837,437) | (1,000,744) |
| Unrecognized net loss/(gain) from past experience different from that assumed and effects of changes in assumptions | 41,399,294 | 37,006,625 | (488,085) | (456,751) |
| Unrecognized prior service cost | <u>79,157</u> | <u>190,310</u> | <u>-</u> | <u>-</u> |
| Accrued benefit costs recognized in the consolidated balance sheet | <u>\$ (19,634)</u> | <u>\$ (2,732,506)</u> | <u>\$ (1,325,522)</u> | <u>\$ (1,457,495)</u> |
| Components of net periodic benefit costs | | | | |
| Service cost | \$ 2,402,724 | \$ 1,536,115 | \$ - | \$ - |
| Interest cost | 6,417,121 | 5,685,930 | 29,884 | 31,620 |
| Expected return on plan assets | (7,920,200) | (7,182,524) | - | - |
| Amortization of net loss/(gain) | 2,676,330 | 3,175,983 | (66,454) | (45,046) |
| Net amortization and deferral | <u>111,153</u> | <u>140,639</u> | <u>-</u> | <u>-</u> |
| Benefit cost | <u>\$ 3,687,128</u> | <u>\$ 3,356,143</u> | <u>\$ (36,570)</u> | <u>\$ (13,426)</u> |

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The weighted average assumptions used to determine the net benefit cost at the beginning of the year are as follows:

| | 2014 | 2013 |
|--|-------------|-------------|
| Discount rate | 4.51 % | 3.95 % |
| Average rate of compensation increases | 2.50 % | 2.50 % |
| Expected return on assets | 7.50 % | 7.50 % |

The weighted average assumptions used to determine the benefit obligation at the end of the year are as follows:

| | 2014 | 2013 |
|--|-------------|-------------|
| Discount rate | 4.05 % | 4.51 % |
| Average rate of compensation increases | 2.50 % | 2.50 % |

The Plan's asset allocations as of September 30 are as follows:

| Asset Category | 2014 | 2013 |
|-----------------------|-------------|-------------|
| Cash | 2 % | 3 % |
| Bonds | 24 | 23 |
| Mutual funds | 45 | 44 |
| Hedge funds | 29 | 30 |
| Total | 100 % | 100 % |

The expected rate of return on assets is calculated based on past experience.

Expected benefits to be paid under the plans are as follows:

| Fiscal Years Beginning October 1, | Expected Benefits |
|--|--------------------------|
| 2014 | \$ 7,399,905 |
| 2015 | 7,694,336 |
| 2016 | 8,101,708 |
| 2017 | 8,234,873 |
| 2018 | 8,658,771 |
| Expected aggregate for 5 fiscal years beginning 2019 | 47,809,642 |

Annual contributions are determined by the Hospital based upon calculations prepared by the plan's actuary. Expected contributions to the plans for 2015 are approximately (unaudited):

| | |
|----------------|--------------|
| Pension | \$ 6,400,000 |
| Retiree health | 94,776 |

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The weighted-average annual assumed rate of increase in the per capita cost of covered benefits (i.e., health care cost trend rate) for participants is assumed to be 9.0% in 2014 reducing to 5.0% by the year 2021 and remaining at that level thereafter. This health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, a one percentage point increase in the assumed health care cost trend rate would increase the accumulated post-retirement benefit obligation and service cost plus interest cost by approximately \$56,000 and \$71,000, respectively, at September 30, 2014 and 2013. A one percentage point decrease in the assumed health care cost trend rate would decrease the accumulated postretirement benefit obligation and service cost plus interest cost by approximately \$51,000 and \$65,000, respectively, at September 30, 2014 and 2013.

Plan Assets

The defined benefit plan assets are valued utilizing the same fair value hierarchy as the Hospital's investments as described in Note 1.

The following table summarizes the fair values of investments by major type held by the pension plan at September 30, 2014:

| | Level 1 | Level 2 | Level 3 | 2014 |
|-----------------------------------|----------------------|---------------------|----------------------|-----------------------|
| Investments, at fair value | | | | |
| Cash | \$ 2,417,830 | \$ - | \$ - | \$ 2,417,830 |
| Bonds | 27,571,791 | - | - | 27,571,791 |
| Mutual funds | \$ 46,557,396 | \$ 5,171,869 | \$ - | \$ 51,729,265 |
| Hedge funds | - | - | 33,457,838 | 33,457,838 |
| Total investments, at fair value | <u>\$ 76,547,017</u> | <u>\$ 5,171,869</u> | <u>\$ 33,457,838</u> | <u>\$ 115,176,724</u> |

The following table summarizes the fair values of investments by major type held by the pension plan at September 30, 2013:

| | Level 1 | Level 2 | Level 3 | 2013 |
|-----------------------------------|----------------------|---------------------|----------------------|-----------------------|
| Investments, at fair value | | | | |
| Cash | \$ 3,043,961 | \$ - | \$ - | \$ 3,043,961 |
| Bonds | 24,488,654 | - | - | 24,488,654 |
| Mutual funds | 41,880,187 | 4,553,588 | - | 46,433,775 |
| Hedge funds | - | - | 31,893,958 | 31,893,958 |
| Total investments, at fair value | <u>\$ 69,412,802</u> | <u>\$ 4,553,588</u> | <u>\$ 31,893,958</u> | <u>\$ 105,860,348</u> |

There were no transfers between levels during 2014 or 2013.

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Notes to Consolidated Financial Statements
September 30, 2014 and 2013

The table below represents the change in fair value measurements for Level 3 investments held by the plan for the years ended September 30:

| | 2014 | 2013 |
|---------------------------|----------------------|----------------------|
| Beginning balances | \$ 31,893,958 | \$ 28,795,536 |
| Realized gains | 4,588,368 | 33,459 |
| Fees | (79,614) | (65,081) |
| Unrealized (losses)/gains | (2,944,874) | 3,130,044 |
| Purchases | - | - |
| Sales | - | - |
| Ending balances | <u>\$ 33,457,838</u> | <u>\$ 31,893,958</u> |

The investment objective for the pension and post retirement plans seeks a positive long-term total return after inflation to meet the Hospital's current and future plan obligations.

Asset allocations combine tested theory and informed market judgment to balance investment risks with the need for high returns.

The Hospital's 401(k) plan covers eligible employees who elect to participate. Eligible employees may contribute a percentage of their salary. The Hospital matches 100% of the first 4% of gross pay deferred by employees for those employees who do not participate in the defined benefit plan. Contributions charged to operations were approximately \$3,296,282 and \$4,047,828 for 2014 and 2013, respectively.

9. Functional Expenses

The Hospital provides general health care services to residents within its geographic location including pediatric care, cardiac catheterization, and outpatient surgery. Expenses by function are as follows:

| | 2014 | 2013 |
|----------------------------|-----------------------|-----------------------|
| Health care services | \$ 258,736,071 | \$ 237,473,487 |
| General and administrative | <u>95,094,590</u> | <u>81,280,293</u> |
| | <u>\$ 353,830,661</u> | <u>\$ 318,753,780</u> |

10. Contingencies

The Hospital is a party to various lawsuits incidental to its business. Management believes that the lawsuits will not have a material adverse effect on the Hospital's financial position, results of operations, changes in net assets or cash flows.

Lawrence + Memorial Hospital
Consolidating Balance Sheet
September 30, 2014

| | Lawrence & Memorial Hospital | Associated Specialists of Connecticut | Eliminating Entities | Consolidated |
|---|---|--|---------------------------------|---------------------|
| Assets | | | | |
| Current assets | | | | |
| Cash and cash equivalents | \$ 6,917,676 | \$ - | \$ - | \$ 6,917,676 |
| Investments | 128,450,331 | - | - | 128,450,331 |
| Patient accounts receivable, net | 36,289,187 | 83,882 | - | 36,373,069 |
| Other receivables | 4,156,260 | - | - | 4,156,260 |
| Inventories | 6,580,753 | - | - | 6,580,753 |
| Due from affiliates | 2,064,619 | - | (109,781) | 1,954,838 |
| Prepaid expenses and other current assets | 2,689,506 | - | - | 2,689,506 |
| Debt service fund | 1,304,562 | - | - | 1,304,562 |
| Total current assets | 188,452,894 | 83,882 | (109,781) | 188,426,995 |
| Assets limited as to use | | | | |
| Cash | 182,862 | - | - | 182,862 |
| Construction funds | 561,676 | - | - | 561,676 |
| Investments held in trust | 925,227 | - | - | 925,227 |
| Endowment investments | 18,987,367 | - | - | 18,987,367 |
| Funds held in trust by others | 6,985,614 | - | - | 6,985,614 |
| Contributions receivable | 20,366 | - | - | 20,366 |
| Funds held in escrow by agreement with State of Connecticut Health and Educational Facilities Authority and trustees | - | - | - | - |
| Total assets limited as to use | 27,663,112 | - | - | 27,663,112 |
| Other assets | | | | |
| Deferred financing costs | 2,315,752 | - | - | 2,315,752 |
| Other receivables | 16,536,719 | - | - | 16,536,719 |
| Property, plant and equipment | 160,857,796 | - | - | 160,857,796 |
| Total assets | \$ 395,826,273 | \$ 83,882 | \$ (109,781) | \$ 395,800,374 |

Lawrence + Memorial Hospital
Consolidating Balance Sheet
September 30, 2014

| | Lawrence & Memorial Hospital | Associated Specialists of Connecticut | Eliminating Entities | Consolidated |
|---|---|--|---------------------------------|-----------------------|
| Liabilities | | | | |
| Current liabilities | | | | |
| Accounts payable | \$ 25,518,874 | \$ 267,160 | \$ - | \$ 25,786,034 |
| Accrued vacation and sick pay | 11,241,300 | 40,401 | - | 11,281,701 |
| Salaries, wages, payroll taxes and amounts withheld from employees | 5,728,350 | 222,217 | - | 5,950,567 |
| Due to affiliates | 2,215,430 | 109,781 | (109,781) | 2,215,430 |
| Due to third party payors | 5,165,225 | - | - | 5,165,225 |
| Current portion of long-term debt | 5,342,305 | - | - | 5,342,305 |
| Total current liabilities | <u>55,211,484</u> | <u>639,559</u> | <u>(109,781)</u> | <u>55,741,262</u> |
| Accrued pension and other postretirement benefits | 43,216,010 | - | - | 43,216,010 |
| Other liabilities | 20,601,530 | - | - | 20,601,530 |
| Long-term debt, less current portion | 108,587,802 | - | - | 108,587,802 |
| Total liabilities | <u>227,616,826</u> | <u>639,559</u> | <u>(109,781)</u> | <u>228,146,604</u> |
| Net assets | | | | |
| Unrestricted | 138,729,444 | (555,677) | - | 138,173,767 |
| Temporarily restricted | 23,432,028 | - | - | 23,432,028 |
| Permanently restricted | 6,047,975 | - | - | 6,047,975 |
| Total net assets | <u>168,209,447</u> | <u>(555,677)</u> | <u>-</u> | <u>167,653,770</u> |
| | <u>\$ 395,826,273</u> | <u>\$ 83,882</u> | <u>\$ (109,781)</u> | <u>\$ 395,800,374</u> |

Lawrence + Memorial Hospital
Consolidating Balance Sheet
September 30, 2013

| | Lawrence & Memorial Hospital | Associated Specialists of Connecticut | Eliminating Entities | Consolidated |
|---|---|--|---------------------------------|-----------------------|
| Assets | | | | |
| Current assets | | | | |
| Cash and cash equivalents | \$ 301,175 | \$ 117,793 | \$ - | \$ 418,968 |
| Investments | 130,950,162 | - | - | 130,950,162 |
| Patient accounts receivable, net | 33,778,305 | 125,603 | - | 33,903,908 |
| Other receivables | 3,938,451 | 38,892 | - | 3,977,343 |
| Inventories | 5,845,470 | - | - | 5,845,470 |
| Due from affiliates | 1,434,568 | - | (117,793) | 1,316,775 |
| Prepaid expenses and other current assets | 2,256,097 | - | - | 2,256,097 |
| Debt service fund | 1,306,255 | - | - | 1,306,255 |
| Total current assets | <u>179,810,483</u> | <u>282,288</u> | <u>(117,793)</u> | <u>179,974,978</u> |
| Assets limited as to use | | | | |
| Cash | 182,366 | - | - | 182,366 |
| Construction funds | 9,541,685 | - | - | 9,541,685 |
| Investments held in trust | 985,034 | - | - | 985,034 |
| Endowment investments | 17,922,954 | - | - | 17,922,954 |
| Funds held in trust by others | 6,773,578 | - | - | 6,773,578 |
| Contributions receivable | 20,366 | - | - | 20,366 |
| Funds held in escrow by agreement with State of Connecticut Health and Educational Facilities Authority and trustees | 2,247,255 | - | - | 2,247,255 |
| Total assets limited as to use | <u>37,673,238</u> | <u>-</u> | <u>-</u> | <u>37,673,238</u> |
| Other assets | | | | |
| Deferred financing costs | 1,776,176 | - | - | 1,776,176 |
| Other receivables | 13,694,110 | - | - | 13,694,110 |
| Property, plant and equipment | 161,990,209 | - | - | 161,990,209 |
| Total assets | <u>\$ 394,944,216</u> | <u>\$ 282,288</u> | <u>\$ (117,793)</u> | <u>\$ 395,108,711</u> |

Lawrence + Memorial Hospital
Consolidating Balance Sheet
September 30, 2013

| | Lawrence & Memorial Hospital | Associated Specialists of Connecticut | Eliminating Entities | Consolidated |
|---|------------------------------------|---|-------------------------|----------------|
| Liabilities | | | | |
| Current liabilities | | | | |
| Accounts payable | \$ 24,077,640 | \$ 2,047 | \$ - | \$ 24,079,687 |
| Accrued vacation and sick pay | 10,888,727 | 634,545 | - | 11,523,272 |
| Salaries, wages, payroll taxes and amounts withheld from employees | 4,108,644 | 386,813 | - | 4,495,457 |
| Due to affiliates | 1,867,732 | 117,793 | (117,793) | 1,867,732 |
| Due to third party payors | 3,826,094 | - | - | 3,826,094 |
| Current portion of long-term debt | 4,487,234 | - | - | 4,487,234 |
| Total current liabilities | 49,256,071 | 1,141,198 | (117,793) | 50,279,476 |
| Accrued pension and other postretirement benefits | 42,309,345 | - | - | 42,309,345 |
| Other liabilities | 17,774,823 | - | - | 17,774,823 |
| Long-term debt, less current portion | 86,439,477 | - | - | 86,439,477 |
| Total liabilities | 195,779,716 | 1,141,198 | (117,793) | 196,803,121 |
| Net assets | | | | |
| Unrestricted | 171,018,998 | (858,910) | - | 170,160,088 |
| Temporarily restricted | 22,198,248 | - | - | 22,198,248 |
| Permanently restricted | 5,947,254 | - | - | 5,947,254 |
| Total net assets | 199,164,500 | (858,910) | - | 198,305,590 |
| | \$ 394,944,216 | \$ 282,288 | \$ (117,793) | \$ 395,108,711 |

Lawrence + Memorial Hospital
Consolidating Statement of Operations
September 30, 2014

| | Lawrence & Memorial Hospital | Associated Specialists of Connecticut | Eliminating Entities | Consolidated |
|---|---|--|---------------------------------|------------------------|
| Net revenues | \$ 333,751,931 | \$ 3,377,261 | \$ - | \$ 337,129,192 |
| Provision for bad debt | (14,966,698) | 36,396 | - | (14,930,302) |
| Net revenue less provision for bad debt | 318,785,233 | 3,413,657 | - | 322,198,890 |
| Other operating revenues | 29,607,174 | 319,074 | (1,775,187) | 28,151,061 |
| Net assets released from restriction | 671,797 | - | - | 671,797 |
| | <u>349,064,204</u> | <u>3,732,731</u> | <u>(1,775,187)</u> | <u>351,021,748</u> |
| Operating expenses | | | | |
| Salaries and wages | 142,343,619 | 1,610,637 | (115,582) | 143,838,674 |
| Employee benefits | 50,942,363 | 361,785 | (259,430) | 51,044,718 |
| Supplies | 59,512,480 | 25,661 | - | 59,538,141 |
| Purchased services | 37,964,369 | 1,604,552 | (921,154) | 38,647,767 |
| Other | 31,491,444 | 3,477,733 | (479,021) | 34,490,156 |
| Interest | 3,542,721 | - | - | 3,542,721 |
| Depreciation and amortization | 22,728,484 | - | - | 22,728,484 |
| | <u>348,525,480</u> | <u>7,080,368</u> | <u>(1,775,187)</u> | <u>353,830,661</u> |
| Income/(loss) from operations | 538,724 | (3,347,637) | - | (2,808,913) |
| Nonoperating gains | | | | |
| Unrestricted income | 180,488 | - | - | 180,488 |
| Income from investments | 8,608,113 | - | - | 8,608,113 |
| | <u>8,788,601</u> | <u>-</u> | <u>-</u> | <u>8,788,601</u> |
| Excess of revenues over expenses | 9,327,325 | (3,347,637) | - | 5,979,688 |
| Transfers (to)/from affiliated entity | (37,512,132) | 3,650,870 | - | (33,861,262) |
| Net unrealized gains on investments | 31,059 | - | - | 31,059 |
| Net assets released from restriction used for purchase of property, plant and equipment | 139,360 | - | - | 139,360 |
| Donated equipment | 6,350 | - | - | 6,350 |
| Pension related changes other than periodic pension costs | (4,281,516) | - | - | (4,281,516) |
| (Decrease)/increase in unrestricted net assets | <u>\$ (32,289,554)</u> | <u>\$ 303,233</u> | <u>\$ -</u> | <u>\$ (31,986,321)</u> |

Lawrence + Memorial Hospital
Consolidating Statement of Operations
September 30, 2013

| | Lawrence & Memorial Hospital | Associated Specialists of Connecticut | Eliminating Entities | Consolidated |
|---|---|--|---------------------------------|----------------------|
| Net revenues | \$ 310,967,942 | \$ 4,416,164 | \$ - | \$ 315,384,106 |
| Provision for bad debt | <u>(12,037,777)</u> | <u>(89,969)</u> | - | <u>(12,127,746)</u> |
| Net revenue less provision for bad debt | 298,930,165 | 4,326,195 | - | 303,256,360 |
| Other operating revenues | 22,653,789 | 463,654 | (3,524,633) | 19,592,810 |
| Net assets released from restriction | <u>508,227</u> | <u>-</u> | <u>-</u> | <u>508,227</u> |
| | <u>322,092,181</u> | <u>4,789,849</u> | <u>(3,524,633)</u> | <u>323,357,397</u> |
| Operating expenses | | | | |
| Salaries and wages | 144,544,364 | 5,408,975 | (127,493) | 149,825,846 |
| Employee benefits | 43,319,912 | 983,325 | (767,809) | 43,535,428 |
| Supplies | 45,122,992 | 48,417 | - | 45,171,409 |
| Purchased services | 22,707,507 | 2,773,480 | (1,858,849) | 23,622,138 |
| Other | 32,978,276 | 1,044,981 | (770,482) | 33,252,775 |
| Interest | 2,705,025 | - | - | 2,705,025 |
| Depreciation and amortization | <u>20,641,159</u> | <u>-</u> | <u>-</u> | <u>20,641,159</u> |
| | <u>312,019,235</u> | <u>10,259,178</u> | <u>(3,524,633)</u> | <u>318,753,780</u> |
| Income from operations | <u>10,072,946</u> | <u>(5,469,329)</u> | <u>-</u> | <u>4,603,617</u> |
| Nonoperating gains | | | | |
| Unrestricted income | 122,109 | - | - | 122,109 |
| Income from investments | <u>6,041,461</u> | <u>-</u> | <u>-</u> | <u>6,041,461</u> |
| | <u>6,163,570</u> | <u>-</u> | <u>-</u> | <u>6,163,570</u> |
| Excess of revenues over expenses | 16,236,516 | (5,469,329) | - | 10,767,187 |
| Transfers from/(to) affiliated entity | (4,467,122) | 5,603,667 | - | 1,136,545 |
| Net unrealized gains on investments | 9,113,432 | - | - | 9,113,432 |
| Net assets released from restriction used for purchase of property, plant and equipment | 167,751 | - | - | 167,751 |
| Pension related changes other than periodic pension costs | <u>5,929,845</u> | <u>-</u> | <u>-</u> | <u>5,929,845</u> |
| Increase in unrestricted net assets | <u>\$ 26,980,422</u> | <u>\$ 134,338</u> | <u>\$ -</u> | <u>\$ 27,114,760</u> |