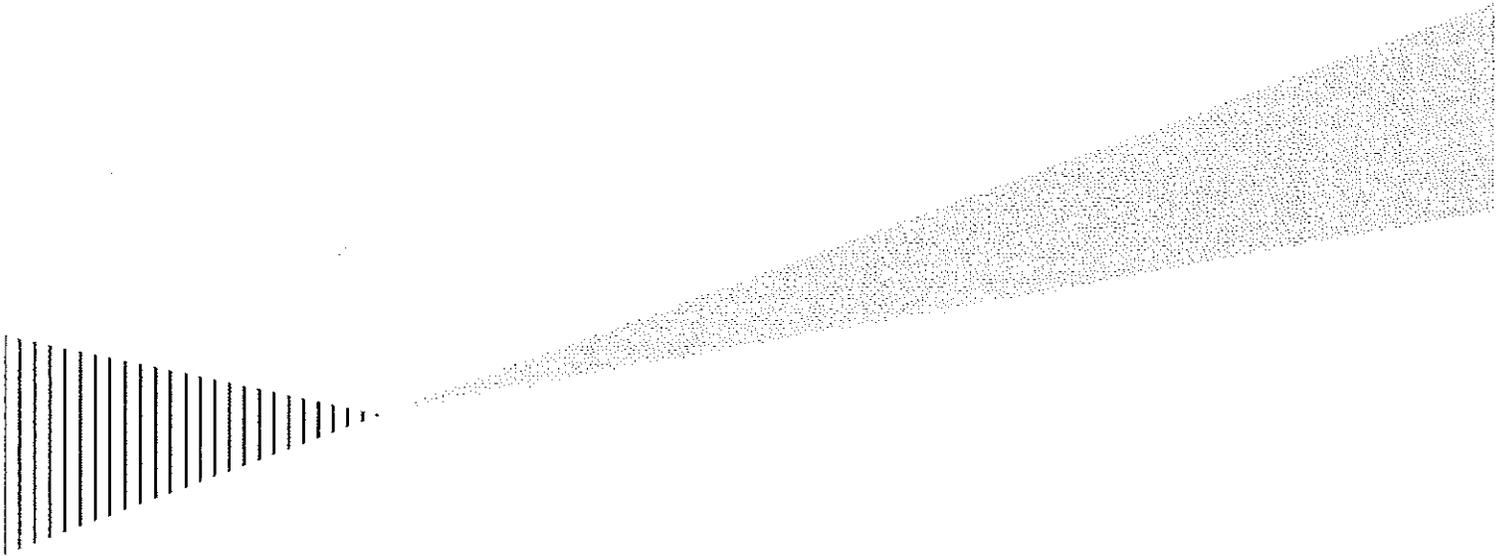


CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

The Danbury Hospital and Subsidiary
Years Ended September 30, 2015 and 2014
With Report of Independent Auditors

Ernst & Young LLP



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The Danbury Hospital and Subsidiary

Consolidated Financial Statements
and Supplementary Information

Years Ended September 30, 2015 and 2014

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Report of Independent Auditors

The Board of Directors
Western Connecticut Health Network, Inc.

We have audited the accompanying consolidated financial statements of The Danbury Hospital and Subsidiary, which comprise the consolidated balance sheets as of September 30, 2015 and 2014, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Western Connecticut Health Network Insurance Co., Ltd. (WCHNIC), a wholly-owned subsidiary, which statements reflect total assets constituting 14% and 13% as of September 30, 2015 and 2014, respectively, and total revenues constituting 4% in 2015 and 2014 of the consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for WCHNIC, is based solely on the report of the other auditors. 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, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Danbury Hospital and Subsidiary at September 30, 2015 and 2014, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating balance sheet and statement of operations are presented for purposes of additional analysis and are not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 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, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst & Young LLP

January 28, 2016

The Danbury Hospital and Subsidiary

Consolidated Balance Sheets
(In Thousands)

	September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 21,694	\$ 50,841
Assets limited as to use, current portion	7,368	9,864
Patient accounts receivable, less allowance for uncollectible accounts of approximately \$13,937 in 2015 and \$14,962 in 2014	76,938	70,378
Due from related parties	6,294	4,432
Inventories	10,950	11,616
Prepaid expenses and other	17,238	23,765
Total current assets	140,482	170,896
Assets limited as to use:		
Investments held by WCHNIC	115,882	97,160
Total noncurrent assets limited as to use	115,882	97,160
Investments	166,957	204,452
Other assets	2,801	2,871
Interest in Western Connecticut Health Network Foundation, Inc.	92,378	108,473
Property, plant, and equipment:		
Land and land improvements	12,308	12,152
Buildings and building improvements	511,120	477,895
Equipment and other	306,225	297,530
Construction in progress (estimated cost to complete at September 30, 2015: \$9,259)	16,766	30,551
	846,419	818,128
Less accumulated depreciation	452,258	425,814
	394,161	392,314
Bond issuance costs, net	3,777	4,611
Total assets	\$ 916,438	\$ 980,777

	September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 36,053	\$ 36,330
Payroll-related accruals	36,985	34,030
Due to third-party payors	18,232	17,434
Current portion due to related parties	-	1,102
Interest payable	1,842	1,791
Other accrued expenses	2,700	3,498
Current portion of long-term debt	1,580	4,925
Total current liabilities	<u>97,392</u>	<u>99,110</u>
Self-insurance liabilities	78,958	82,107
Accrued pension liabilities and other	20,082	34,185
Due to related parties, less current portion	-	178
Long-term debt, less current portion	243,270	241,775
Total liabilities	<u>439,702</u>	<u>457,355</u>
Net assets:		
Unrestricted	406,110	438,302
Temporarily restricted	36,051	51,323
Permanently restricted	34,575	33,797
Total net assets	<u>476,736</u>	<u>523,422</u>

Total liabilities and net assets

\$	<u>916,438</u>	\$	<u>980,777</u>
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See accompanying notes.

The Danbury Hospital and Subsidiary

Consolidated Statements of Operations and Changes in Net Assets
(In Thousands)

	Year Ended September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Unrestricted revenues:		
Net patient service revenue	\$ 614,030	\$ 605,824
Provision for uncollectible accounts	21,154	19,028
Net patient service revenue, less provision for uncollectible accounts	592,876	586,796
Net assets released from restrictions	6,073	5,685
Other operating revenue	23,816	24,519
	<u>622,765</u>	<u>617,000</u>
Expenses:		
Salaries, benefits, and fees	357,097	338,890
Supplies and other	178,953	175,031
Insurance	9,682	21,592
Depreciation and amortization	45,374	37,160
Interest	7,442	4,556
State of Connecticut Hospital Tax	24,402	20,783
	<u>622,950</u>	<u>598,012</u>
(Loss) income from operations before loss on extinguishment of long-term debt	(185)	18,988
Loss on extinguishment of long-term debt	(1,357)	—
(Loss) income from operations	<u>(1,542)</u>	<u>18,988</u>
Nonoperating gains and (losses):		
Investment income, net	4,223	3,418
Change in unrealized gains and losses on investments	(6,686)	11,254
Change in equity interest in unrestricted net assets of the Western Connecticut Health Network Foundation, Inc.	(1,601)	(47)
	<u>(4,064)</u>	<u>14,625</u>
(Deficiency) excess of revenues over expenses	<u>(5,606)</u>	<u>33,613</u>

Continued on next page.

The Danbury Hospital and Subsidiary

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

	Year Ended September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Unrestricted net assets:		
(Deficiency) excess of revenues over expenses (continued)	\$ (5,606)	\$ 33,613
Net assets released from restrictions for property, plant, and equipment	5,804	16,400
Change in pension obligation	(2,037)	(7,006)
Transfer from Maple Street Indemnity Company, Ltd.	—	15,454
Transfers to Western Connecticut Health Network, Inc.	(30,353)	(44,422)
(Decrease) increase in unrestricted net assets	(32,192)	14,039
Temporarily restricted net assets:		
Change in equity interest of the Western Connecticut Health Network Foundation, Inc.	(15,272)	(9,406)
Transfers from Western Connecticut Health Network Foundation, Inc.	11,877	22,085
Net assets released from restrictions	(6,073)	(5,685)
Net assets released from restrictions for property, plant, and equipment	(5,804)	(16,400)
Decrease in temporarily restricted net assets	(15,272)	(9,406)
Permanently restricted net assets:		
Change in equity interest of the Western Connecticut Health Network Foundation, Inc.	778	414
Increase in permanently restricted net assets	778	414
(Decrease) increase in net assets	(46,686)	5,047
Net assets at beginning of year	523,422	518,375
Net assets at end of year	\$ 476,736	\$ 523,422

See accompanying notes.

The Danbury Hospital and Subsidiary

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Operating activities		
(Decrease) increase in net assets	\$ (46,686)	\$ 5,047
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	45,374	37,160
Change in unrealized gains and losses on investments	6,686	(11,254)
Decrease in equity interest in net assets of the Western Connecticut Health Network Foundation, Inc.	16,095	9,040
Transfers from the Western Connecticut Health Network Foundation, Inc.	(11,877)	(22,085)
Loss on extinguishment of long-term debt	1,357	—
Transfer from Maple Street Indemnity Company, Ltd.	—	(15,454)
Transfers to Western Connecticut Health Network, Inc.	30,353	44,422
Change in pension obligation	2,037	7,006
Provision for uncollectible accounts	21,154	19,028
Increase (decrease) in accrued pension liabilities and other	59	(1,966)
(Decrease) increase in self-insurance liabilities	(3,149)	4,296
Changes in operating assets and liabilities <i>(see Note 12)</i>	(16,888)	(24,393)
Net cash provided by operating activities	44,515	50,847
Investing activities		
Additions to property, plant, and equipment, net	(47,221)	(92,018)
Increase in due from related parties and transfers to Western Connecticut Health Network, Inc. and affiliates	(49,694)	(43,803)
Drawdown of construction funds	—	45,695
Purchases and sales of investments, net	14,583	9,162
Net cash used in investing activities	(82,332)	(80,964)
Financing activities		
Proceeds from issuance of bonds	122,120	—
Payments of long-term debt	(125,327)	(2,880)
Transfers from the Western Connecticut Health Network Foundation, Inc.	11,877	22,085
Net cash provided by financing activities	8,670	19,205
Net decrease in cash and cash equivalents	(29,147)	(10,912)
Cash and cash equivalents at beginning of year	50,841	61,753
Cash and cash equivalents at end of year	\$ 21,694	\$ 50,841

See accompanying notes.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (Dollars in Thousands)

September 30, 2015

1. Summary of Significant Accounting Policies

Organization and Basis of Presentation

The Danbury Hospital (the Hospital) is a voluntary, nonprofit association incorporated under the General Statutes of the State of Connecticut, and is a member of Western Connecticut Health Network, Inc. (the Network). The Board of Danbury Hospital is appointed by the Network.

Western Connecticut Health Network Insurance Co., Ltd (WCHNIC) is a captive insurance company domiciled in the Cayman Islands that provides alternative general and professional liability insurance to several subsidiaries of the Network and is a wholly owned subsidiary of the Hospital. As a result of an affiliation agreement by and between the Network and Norwalk Health Services Corporation (NHSC), effective January 1, 2014, Maple Street Indemnity Company, Ltd. (MSIC), NHSC's former wholly owned captive insurance company, merged with WCHNIC on March 1, 2014. As a result, MSIC transferred cash of \$1,800; \$45,013 in investments; \$31,430 in unpaid claims liabilities; and other assets and liabilities, net of \$70, to WCHNIC.

Merger of The New Milford Hospital Incorporated

On October 1, 2014 (the merger date), the Hospital received a single provider license to include The New Milford Hospital Incorporated (New Milford Hospital). As a result, New Milford Hospital merged with the Hospital and the operations of New Milford Hospital became a department of Danbury Hospital effective October 1, 2014. Prior to the merger date, New Milford Hospital was a voluntary, not-for-profit, non-stock corporation incorporated under the General Statutes of the State of Connecticut and was a member of the Network under common control with the Hospital. The Hospital will operate as one licensed facility with two campuses. In accordance with Accounting Standards Codification Topic 805, *Business Combinations*, this transaction was accounted for similar to a pooling of interests with retrospective adjustment in prior period financial statements for the period in which the entities were under common control. Therefore, the Hospital's consolidated financial statements and relevant disclosures as of and for the year ended September 30, 2014 have been adjusted to include New Milford Hospital.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

As of and for the year ended September 30, 2014, there were intercompany transactions which required eliminations and adjustments from the consolidated balance sheet and results of operations. There were no adjustments necessary to conform to accounting practices of the combining companies. Selected financial information for the combining entities included in the accompanying consolidated financial statements as of and for the year ended September 30, 2014 is as follows:

Total assets:	
Danbury Hospital (as previously reported)	\$ 920,864
New Milford Hospital	66,789
Intercompany eliminations	(6,876)
As adjusted	<u>\$ 980,777</u>
Total net assets:	
Danbury Hospital (as previously reported)	\$ 489,294
New Milford Hospital	34,128
As adjusted	<u>\$ 523,422</u>
Total unrestricted revenues and other support:	
Danbury Hospital (as previously reported)	\$ 535,783
New Milford Hospital	62,814
Reclassification	20,783
Intercompany eliminations	(2,380)
As adjusted	<u>\$ 617,000</u>
Excess (deficiency) of revenues over expenses:	
Danbury Hospital (as previously reported)	\$ 35,632
New Milford Hospital	(2,019)
As adjusted	<u>\$ 33,613</u>

Principles of Consolidation

Throughout these notes to the consolidated financial statements, the term Hospital refers to the consolidated entity, The Danbury Hospital, including the campus of New Milford Hospital, and WCHNIC. All material intercompany transactions have been eliminated.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of 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 amounts reported in the consolidated financial statements and related footnotes. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates. Significant estimates reflected in the consolidated financial statements include contractual allowances and allowance for uncollectible accounts for patient service revenue and the related patient accounts receivable, estimated revenue settlements due to or from third parties, reserves for malpractice, workers' compensation and other self-insured 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.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with maturities of three months or less at date of purchase, other than amounts held in the investment portfolio and assets limited as to use. The carrying value of cash equivalents approximates its fair value. 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.

Investments

The Hospital's investment portfolio reported in the accompanying consolidated balance sheets is designated as trading. Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value, based upon quoted market prices. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in the (deficiency) excess of revenues over expenses unless the income or loss is restricted by donor or law.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Alternative investments (non-traditional, not-readily-marketable assets), some of which are structured such that the Hospital holds limited partnership interests, 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 non-marketable and market-traded securities. Valuations of these investments and, therefore, the Hospital's holdings, may be determined by the investment manager or general partner, and for "fund of funds" investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. The Hospital 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 the Hospital's annual consolidated financial statement reporting.

Fair Value of Financial Instruments

The carrying values of financial instruments classified as current assets and current liabilities as of September 30, 2015 and 2014, approximate fair value based on current market conditions. The fair values of other financial instruments are disclosed in the respective notes and/or in Note 4.

Assets Limited as to Use

Assets limited as to use include the investments held by WCHNIC for the purpose of paying future malpractice losses. Assets limited as to use are reported at fair value based upon quoted market prices. The portion of amounts required for funding current liabilities is included in current assets.

Patient Accounts Receivable

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

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

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

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

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

The Hospital's primary concentration of credit risk is patient accounts receivable, which consists of amounts owed by various governmental agencies, insurance companies, and private patients.

Inventories

The Hospital uses the first-in, first-out method, in the valuation of its inventory.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. The Hospital provides for depreciation of property, plant, and equipment using the straight-line method in amounts sufficient to depreciate the cost of the assets over their estimated useful lives. The useful lives range from 1 to 55 years.

Interest in the Western Connecticut Health Network Foundation, Inc.

The interest in the Western Connecticut Health Network Foundation, Inc. (WCHNF) represents the Hospital's interest in the net assets of the WCHNF and is accounted for in accordance with Accounting Standards Codification 958-20, *Not-for-Profit Entities – Financially Interrelated Entities* (see Note 10).

Bond Issuance Costs

Premium discounts and deferred costs related to the issuance of bonds are amortized over the period the obligation is outstanding, using a method that approximates the effective interest method. Accumulated amortization of discounts and deferred costs was \$1,167 and \$1,322 at September 30, 2015 and 2014, respectively. During 2015, the Hospital wrote off \$1,357 of bond issuance costs and paid \$797 in additional bond issuance costs in conjunction with a refinancing (see Note 5).

(Deficiency) Excess of Revenues Over Expenses

The accompanying consolidated statements of operations and changes in net assets include the (deficiency) excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from the (deficiency) excess of revenues over expenses, include permanent transfers of assets to and from affiliates for other than goods and services, net assets released from restriction for purchases of property, plant, and equipment, and changes in the pension obligation. Transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported within (loss) income from operations.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Other Operating Revenue

Other operating revenue consists primarily of the net premiums and interest income of WCHNIC, support services, services provided to other Network affiliates, grant income, education and research income, and rental income of the Hospital (see Note 14).

Nonoperating Gains (Losses)

Activities other than in connection with providing health care services are considered to be nonoperating. Nonoperating gains (losses) primarily consist of investment income, net, change in unrealized gains and losses on investments, and change in equity interest in unrestricted net assets of WCHNF.

Temporarily and Permanently Restricted Net Assets

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

Income Taxes

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Hospital is also exempt from state and local taxes. WCHNIC is a foreign corporation exempt from U.S. taxation and is not subject to taxes under the Cayman Islands tax concessions law.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

WCHNF is a 501(c)(3) organization whose tax-exempt status is based upon its support of the Network and the health care providers affiliated with it, including the Hospital and other health care organizations from time to time associated with the Network which qualify as exempt organizations under Section 501(c)(3) of the Code. The WCHNF was formed to receive and administer funds for the benefit of the Network's not-for-profit corporations, which are exempt from federal income tax.

The Hospital has net operating loss carryforwards from unrelated business activities of approximately \$47,341 and \$46,692 at September 30, 2015 and 2014, respectively, which will begin expiring in 2019. These losses generate a potential deferred tax asset of approximately \$18,936 and \$18,677 at September 30, 2015 and 2014, respectively, which is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future periods.

Asset Retirement Obligation

During 2015 and 2014, retirement obligations incurred and settled were minimal.

Electronic Health Record Incentive Program

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in calendar year 2011 for eligible hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology. The Hospital utilizes a grant accounting model to recognize EHR incentive revenues. Under this accounting policy, EHR incentive payments are recognized as revenues when attestation that the EHR meaningful use criteria for the required period of time was demonstrated. Accordingly, the Hospital recognized \$66 and \$753 of EHR revenues during its fiscal years ended September 30, 2015 and 2014, respectively, consisting of \$14 of Medicaid revenues in 2015 and \$52 and \$753 of Medicare revenues in 2015 and 2014, respectively. EHR revenues are included in other operating revenue in the accompanying consolidated 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.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

State of Connecticut Hospital Tax

Pursuant to Connecticut General Statutes, the State of Connecticut Hospital Tax is based on a percentage of the Hospital's net patient service revenue. Inpatient and outpatient service revenue was taxed at 6.0% and 5.5%, and 6.0% and 3.8%, respectively, for the period July 1, 2015 through September 30, 2015 and October 1, 2013 through June 30, 2015, respectively.

Reclassifications

Certain reclassifications have been made to the year ended September 30, 2014 balances previously reported in the consolidated balance sheets and consolidated statements of operations and changes in net assets in order to conform with the year ended September 30, 2015 presentation. State of Connecticut Hospital Tax in the amount of \$20,783 was reclassified from a deduction to net patient service revenue to an operating expense.

New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The adoption of ASU 2014-09, as amended by ASU 2015-14, is required on October 1, 2018, and management is currently evaluating the effect of this guidance on its consolidated financial statements.

2. Net Patient Service Revenue and Charity Care

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. The difference is accounted for as allowances. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, fee-for-service, discounted charges, and per diem payments. Net patient service revenue is affected by the State of Connecticut Disproportionate Share program and is reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to ongoing and future

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

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

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.

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

During 2015 and 2014, approximately 35%, 7% and 58%, and 33%, 6% and 61%, respectively, of net patient service revenue was received from Medicare, Medicaid and non-governmental payors, 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 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%, 13% and 57%, and 37%, 13% and 50%, for Medicare, Medicaid and non-government payors, respectively, at September 30, 2015 and 2014, respectively.

The Hospital believes it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital. Cost reports for the Hospital, which serves as the basis for the final settlement with government payors, have been settled by final settlement through 2012 for Medicare and 1996 for Medicaid. Other years remain open for settlement.

During 2015 and 2014, the Hospital recorded an increase in net patient service revenue of approximately \$6,682 and \$1,333, respectively, related to changes in previously estimated third-party payor settlements.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

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

The following summarizes net patient service revenue:

	Year Ended September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Gross patient service revenue	\$ 1,544,328	\$ 1,463,361
Deductions:		
Allowances	914,023	844,001
Charity care (at charges)	16,275	13,536
	<u>930,298</u>	<u>857,537</u>
Net patient service revenue	614,030	605,824
Provision for uncollectible accounts	21,154	19,028
Net patient service revenue less provision for uncollectible accounts	<u>\$ 592,876</u>	<u>\$ 586,796</u>

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

	Year Ended September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Third-party payors	\$ 587,650	\$ 582,597
Self-pay patients	26,380	23,227
	<u>\$ 614,030</u>	<u>\$ 605,824</u>

The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity care patient by reference to 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, but also includes certain cases where incurred charges are significant when compared to a responsible party's income. Those charges are not included in net patient service revenue for financial reporting purposes.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

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

The estimated cost of charity care provided was approximately \$6,405 and \$5,274 for the years ended September 30, 2015 and 2014, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

3. Investments and Assets Limited as to Use

The composition of investments and assets limited as to use is set forth in the following table:

	September 30	
	2015	2014
Cash and cash equivalents	\$ 29,487	\$ 50,922
Money market funds	16,880	1,869
Common collective funds	77,272	78,056
Fixed income securities	51	16,123
Mutual funds	141,529	138,541
Alternative investments (at equity method)	24,988	25,965
	<u>\$ 290,207</u>	<u>\$ 311,476</u>

Investment income, net, included in non-operating gains (losses) for the year ended September 30 consists of:

	2015	2014
		<i>(As Adjusted)</i>
Interest and dividend income	\$ 3,100	\$ 2,586
Realized gains and losses, net and equity income on alternative investments	1,123	832
	<u>\$ 4,223</u>	<u>\$ 3,418</u>

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Fair Values of Financial Instruments

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

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

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

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

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

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

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Fair Values of Financial Instruments (continued)

Financial assets carried at fair value in the accompanying consolidated balance sheets are classified in the tables below in one of the three categories described above:

	September 30, 2015			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 21,694	\$ --	\$ --	\$ 21,694
Investments and assets limited as to use:				
Cash and cash equivalents	46,367	--	--	46,367
Mutual funds:				
Fixed income	141,529	--	--	141,529
Common collective funds:				
Domestic equity	--	60,804	--	60,804
International equity	--	16,468	--	16,468
Securities:				
Fixed income	--	51	--	51
	<u>\$ 209,590</u>	<u>\$ 77,323</u>	<u>\$ --</u>	<u>\$ 286,913</u>

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
		<i>(As Adjusted)</i>		
Cash and cash equivalents	\$ 50,841	\$ --	\$ --	\$ 50,841
Investments and assets limited as to use:				
Cash and cash equivalents	52,791	--	--	52,791
Mutual funds:				
Fixed income	138,541	--	--	138,541
Common collective funds:				
Domestic equity	--	61,417	--	61,417
International equity	--	16,639	--	16,639
Securities:				
Fixed income	8,515	7,608	--	16,123
	<u>\$ 250,688</u>	<u>\$ 85,664</u>	<u>\$ --</u>	<u>\$ 336,352</u>

The amounts reported in the tables above do not include alternative investments totaling \$24,988 and \$25,965 at September 30, 2015 and 2014, respectively, which are accounted for under the equity method of accounting. The Hospital has unfunded commitments to alternative investments of approximately \$3,279 as of September 30, 2015.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Fair Values of Financial Instruments (continued)

Financial assets carried at fair value included in the defined benefit pension plan of New Milford Hospital (see Note 6) as of September 30, 2014 are classified in the table below in one of the three categories described above. On September 30, 2015 the New Milford Hospital pension plan merged into the Network's plan and all plan assets were transferred to the Network as of that date.

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
Mutual funds:				
Domestic equity	\$ 21,673	\$ --	\$ --	\$ 21,673
International equity	3,150	--	--	3,150
Fixed income	25,159	--	--	25,159
Other	3,017	--	--	3,017
	<u>\$ 52,999</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 52,999</u>

Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 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. Many of the investments categorized in Level 2 consist of shares or units in investment funds, as opposed to direct interests in the funds' underlying holdings, which may be marketable.

5. Long-Term Debt and Credit Facility

Long-term debt consisted of the following:

	September 30	
	2015	2014
Intercompany debt with Western Connecticut Health Network, Inc.	\$ 244,850	\$ 246,700
	<u>244,850</u>	<u>246,700</u>
Less current portion	1,580	4,925
	<u>\$ 243,270</u>	<u>\$ 241,775</u>

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

5. Long-Term Debt and Credit Facility (continued)

The following is a summary of the combined aggregate amount of maturities and sinking fund requirements of the aforementioned obligations at September 30, 2015, according to their long-term amortization schedule:

2016	\$	1,580
2017		1,640
2018		1,710
2019		1,760
2020		1,845
Thereafter		236,315
	\$	<u>244,850</u>

The fair value of the Hospital's long-term debt as determined by the Hospital's investment advisor using a discounted cash flow analysis was approximately \$254,511 and \$256,598 at September 30, 2015 and 2014, respectively. These fair values are categorized as Level 2 in the fair value hierarchy described in Note 4.

The Hospital paid interest of \$7,589 and \$7,784 in 2015 and 2014, respectively. The Hospital has capitalized interest of approximately \$198 and \$3,311 in 2015 and 2014, respectively. Debt service funds held under bond indenture agreements for Series H Bonds and Series N Bonds were \$1,868 and \$1,869 at September 30, 2015 and 2014, respectively.

The Network holds four series of bonds. In 2011, the Obligated Group was expanded to include the Network, New Milford Hospital, and Western Connecticut Medical Group, P.C. (WCMG). During May 2015, the Norwalk Hospital Association (NHA) and Norwalk Hospital Foundation were added to the Obligated Group. All proceeds from the bonds were used to finance Hospital capital projects. All members of the Obligated Group are jointly and severally liable under the Master Indenture to make all payments required with respect to obligations under the Master Indenture. The bonds are reflected as intercompany debt in the schedule above, and include: The Series K 2011 revenue bonds (Series K Bonds) were issued in the amount of \$33,035. The Series K Bonds were scheduled to mature serially from September 30, 2011 to September 30, 2036 at a bank purchase interest rate (1.390% at September 30, 2014). In 2015, the Series K Bonds were refunded in conjunction with the issuance of the Series O revenue bonds (Series O Bonds).

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

5. Long-Term Debt and Credit Facility (continued)

The Series H revenue bonds (Series H Bonds) mature from 2030 through 2036 at an average coupon rate of 4.425%. The proceeds of the Series H Bonds were used for the construction, renovation, and equipping of an outpatient diagnostic building with approximately 28,000 square feet of medical office space, a 381-space parking garage, a 264-space surface parking lot, and to fund capitalized interest. The scheduled payment of principal and interest on the Series H Bonds when due is guaranteed by an insurance policy issued by a commercial insurer.

Under the original terms of the Series H Bonds financing arrangements between the Hospital and WCHNF (the Obligated Group) and CHEFA, the proceeds of the revenue bonds were loaned to the Hospital. The Hospital was obligated to provide amounts sufficient to pay the principal and interest due on the Series H Bonds. The Master Indentures and Supplemental Master Indentures provide for the potential establishment and maintenance of a Debt Service Reserve Fund and a pledge of gross receipts, as defined. The Master Indentures also establish a debt service coverage ratio requirement and restricts the incurrence of certain indebtedness by the Obligated Group. No violations of financial covenants existed as of September 30, 2015 or 2014.

The Series M 2011 revenue bonds (Series M Bonds) were issued in the aggregate principal of \$46,030, with interest payable initially on January 1, 2012, and semiannually on each January 1 and July 1 thereafter. The Series M Bonds bear interest at rates ranging from 5.000% to 5.375% and are scheduled to mature from July 1, 2031 to July 1, 2041. The Series M Bonds are also subject to annual sinking fund installments commencing in 2024 through scheduled maturity. The Series L 2011 revenue bonds (Series L Bonds) of \$96,000 were issued concurrently with Series M Bonds and were subject to annual sinking fund installments commencing July 1, 2015, and continuing through final maturity on July 1, 2041. The Series L Bonds bore interest at a bank purchase rate (1.298% at September 30, 2014). In 2015, the Series L Bonds were also refunded in conjunction with the issuance of the Series O Bonds. The proceeds of the Series L Bonds and Series M Bonds were used for funding the planning, design, acquisition, construction, equipping and furnishing of the Hospital's new patient tower, expansion of a parking garage, capital improvements, and to fund capitalized interest.

In 2012, the Network issued Series N Bonds in the amount of \$39,880 and bearing interest at rates between 3% and 5%. The Series N Bonds mature serially from July 1, 2014 to July 1, 2029. The proceeds of the Series N Bonds were used to refund the Hospital's Series G Bonds.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

5. Long-Term Debt and Credit Facility (continued)

In 2015, the Network issued Series O Bonds in the amount of \$122,120 which bear interest at a variable rate tied to LIBOR (.979% at September 30, 2015). The Series O Bonds mature serially from July 1, 2022 to July 1, 2041. The proceeds of the Series O Bonds were used to refund the Network's Series K and Series L Bonds which were fully redeemed as of September 30, 2015. The Hospital recorded a loss on the extinguishment of long-term debt of \$1,357 in the consolidated statement of operations in 2015.

6. Pension Plans

The Hospital participates in a non-contributory defined benefit pension plan sponsored by the Network covering substantially all of its employees. Contributions are made to the plan in amounts sufficient to meet the Employee Retirement Income Security Act's minimum funding requirements. Net periodic pension income allocated to the Hospital was \$4,737 and \$6,655 for 2015 and 2014, respectively. In 2012, the defined benefit pension plan was frozen. As a result of the plan being frozen, the Network established a defined contribution plan for all employees. Pension expense related to the defined contribution plan was \$14,206 and \$11,475 for fiscal years 2015 and 2014, respectively.

The Network's defined benefit pension plan had an estimated projected benefit obligation of \$659,389 and \$556,603 at September 30, 2015 and 2014, respectively, and the fair value of plan assets was \$537,226 and \$482,884 at September 30, 2015 and 2014, respectively. The discount rate used to determine the benefit obligation was 4.43% and 4.62% at September 30, 2015 and 2014, respectively.

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

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

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

6. Pension Plans (continued)

Effective September 30, 2015 the New Milford Hospital pension plan merged into the Network's plan. As a result, the benefit obligation and plan assets were transferred to the Network as of this date.

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

	September 30	
	2015	2014
Changes in benefit obligations		
Benefit obligations at beginning of year	\$ 67,435	\$ 58,717
Service cost	132	135
Interest cost	3,001	3,021
Assumption changes	941	7,750
Actuarial (gain) loss	(1,392)	434
Benefits paid	(2,726)	(2,622)
Transfer to Network plan	(67,391)	-
Benefit obligations at end of year	-	67,435
Changes in plan assets		
Fair value of plan assets at beginning of year	52,999	50,451
Actual return on plan assets	(343)	4,151
Employer contributions	1,262	1,179
Expenses	-	(160)
Benefits paid	(2,726)	(2,622)
Transfer to Network plan	(51,192)	-
Fair value of plan assets at end of year	-	52,999
Unfunded status, included in accrued pension liabilities and other on accompanying consolidated balance sheets	\$ -	\$ (14,436)

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

6. Pension Plans (continued)

	Year Ended September 30	
	2015	2014
Components of net periodic benefit cost		
Service cost	\$ 132	\$ 135
Interest cost	3,001	3,021
Expected return on plan assets	(3,920)	(3,961)
Amortization of prior service cost	(43)	(43)
Recognized net loss	1,818	1,191
Net periodic benefit cost	<u>\$ 988</u>	<u>\$ 343</u>

Assumptions

	2015	2014
Weighted-average assumptions used to determine benefit obligations		
Discount rate	N/A	4.56%
Rate of increase in compensation	N/A	3.00%
Weighted-average assumptions used to determine net periodic benefit cost		
Discount rate	4.56%	5.23%
Rate of increase in compensation	3.00%	3.00%
Expected long-term return on plan assets	7.50%	8.00%

New Milford Hospital's expected long-term rate of return on assets assumption was derived from a review of anticipated future long-term performance of individual asset classes and consideration of the appropriate asset allocation strategy given the anticipated requirements of the Plan to determine the average rate of earnings expected on the funds invested to provide for the pension plan benefits. While the review gives appropriate consideration to recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate.

Amounts recorded in unrestricted net assets and not yet amortized as components of net periodic benefit cost totaled \$24,167 as of September 30, 2014 and represented unrecognized actuarial losses.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

6. Pension Plans (continued)

The accumulated benefit obligation was \$67,014 and \$66,888 as of September 30, 2015 and 2014, respectively. The Plan's measurement date was September 30.

Plan Assets

The Plan maintained target allocation percentages among various asset classes based on an investment policy established for the Plan which was designed to achieve long-term objectives of return, while mitigating against downside risk and considering expected cash flows. The weighted-average target asset allocation was 50% equity securities and 50% debt securities. The assets of the Plan were all held in mutual funds and were transferred to the Network's plan on September 30, 2015.

As discussed in Note 4, New Milford Hospital follows a three-level hierarchy to categorize assets measured at fair value. In accordance with the hierarchy, as of September 30, 2014, 100% of the Plan assets were categorized as Level 1 investments. Securities with readily determinable values are carried at fair value as determined based on independent public sources.

7. Professional Liability Self-Insurance

Effective October 1, 2004, the Hospital formed a captive insurance company, WCHNIC, domiciled in the Cayman Islands, to provide alternative general and professional liability insurance to the Hospital and WCMG, as well as provide community doctors with a competitive professional liability insurance option.

Effective October 1, 2010, New Milford Hospital became insured by WCHNIC. Prior to this date New Milford Hospital was commercially insured.

Effective March 1, 2014, NHSC and affiliates became insured by WCHNIC. In addition, all claims prior to March 1, 2014 that were previously insured by MSIC were assumed by WCFNIC through a loss portfolio transfer, at which time all risk was assumed.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Professional Liability Self-Insurance (continued)

Coverage for medical malpractice insurance is on a claims-made basis. The coverage limits are \$5,000 per claim and \$30,000 in the aggregate. The excess indemnity coverage is \$40,000 per claim and \$40,000 in the aggregate. The Hospital has recorded a liability of \$10,246 and \$10,490 at September 30, 2015 and 2014, respectively, based on a discount rate of 3.5% for incurred-but-not-reported claims, which is included in accrued pension liabilities and other on the accompanying consolidated balance sheets.

Assets held by WCHNIC approximate \$132,832 and \$123,703 as of September 30, 2015 and 2014, respectively, of which a majority is reflected as assets limited as to use in the accompanying consolidated balance sheets. Total liabilities recorded by WCHNIC approximate \$79,138 and \$82,267 as of September 30, 2015 and 2014, respectively, of which a majority is reflected as self-insurance liabilities in the accompanying consolidated balance sheets.

The reserve for losses and loss adjustment expenses for WCHNIC are included in self-insurance liabilities in the accompanying consolidated balance sheets. Activity in the reserve for losses and loss adjustment expenses for the years ended September 30, 2015 and 2014, is summarized as follows:

	2015	2014
Balance at beginning of year	\$ 81,991	\$ 46,295
Incurred related to:		
Current period	15,364	17,017
Prior period	(8,755)	1,916
Total incurred	6,609	18,933
Paid related to:		
Current period	(335)	(160)
Prior period	(9,414)	(14,507)
Total paid	(9,749)	(14,667)
Add: Transfer of unpaid losses from MSIC	-	31,430
Net provision for losses and loss adjustment expenses	\$ 78,851	\$ 81,991

Also included in self-insurance liabilities as of September 30, 2015 and 2014, are unearned premiums of \$107 and \$116, respectively.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Professional Liability Self-Insurance (continued)

WCHNIC uses an actuary to estimate the liability for unpaid losses based on industry data, as well as entity-specific data. Management considers the liability to be adequate as of September 30, 2015 and 2014; however, no assurance can be given that the ultimate settlement of losses may not vary materially from the liability recorded. Future adjustments to the amounts recorded resulting from the continual review process, as well as differences between estimates and ultimate payments, will be reflected in the consolidated statements of operations and changes in net assets of future years when such adjustments, if any, become known.

8. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets of \$36,051 and \$51,323 as of September 30, 2015 and 2014, respectively, are available to the Hospital for health care services. Permanently restricted net assets total \$34,575 and \$33,797 as of September 30, 2015 and 2014, respectively, and are investments to be held in perpetuity, the income from which is expendable to support health care services.

9. Endowments

The WCHNF endowment consists of approximately 34 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported in the accompanying consolidated balance sheets based on the existence or absence of donor-imposed restrictions.

WCHNF classifies net assets of donor-restricted endowment funds for organizations subject to an enacted Uniform Prudent Management of Institutional Funds Act (UPMIFA). Connecticut enacted its UPMIFA statute effective October 1, 2007. This standard requires not-for-profit organizations subject to an enacted version of UPMIFA to classify the portion of the endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time and purpose restricted) until appropriated for expenditure by the organization. The portion to be classified as temporarily restricted consists of accumulated unspent income and appreciation.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

9. Endowments (continued)

Leadership of WCHNF 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, WCHNF classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time of the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, WCHNF 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 WCHNF 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 WCHNF
- (7) The investment policies of WCHNF

WCHNF 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 WCHNF must hold in perpetuity or for a donor-specific period(s) as well as board-designated funds. Under this policy, as approved by the Network's 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 5% over the long term. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, WCHNF 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). WCHNF targets a diversified asset

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

9. Endowments (continued)

allocation to achieve its long-term objective within prudent risk constraints. Each year, the WCHNF Board of Directors will approve an endowment and similar fund spending rate. The objectives of the portfolio are the enhancement of capital and real purchasing power while limiting exposure to risk of loss. The endowment spending rate will be calculated on the 13 quarter trailing average market value of each portfolio as of the prior May 31. The computed value may be adjusted for large contributions, withdrawals, or market value swings as necessary. A default spending cap on appreciation of seven percent in any given year is currently in effect. The WCHNF Board abides by these regulations and will adjust this rate accordingly.

Endowment net asset composition by type of fund as of September 30, 2015 consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 10,857	\$ 27,569	\$ 38,426
Board-designated endowment funds	8,116	-	-	8,116
Endowment funds at end of year	<u>\$ 8,116</u>	<u>\$ 10,857</u>	<u>\$ 27,569</u>	<u>\$ 46,542</u>

Changes in endowment funds for the fiscal year ended September 30, 2015, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment funds at beginning of the year	\$ 9,785	\$ 13,428	\$ 26,039	\$ 49,252
Investment return:				
Investment income, net	193	735	-	928
Change in unrealized gains and losses	(362)	(1,347)	-	(1,709)
Total investment return	(169)	(612)	-	(781)
Contributions	-	183	1,530	1,713
Appropriation of endowment assets for expenditures	(1,500)	(2,293)	-	(3,793)
Other changes:				
Net asset reclassification-net loss on endowments	-	151	-	151
Endowment funds at end of year	<u>\$ 8,116</u>	<u>\$ 10,857</u>	<u>\$ 27,569</u>	<u>\$ 46,542</u>

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

9. Endowments (continued)

Endowment net asset composition by type of fund as of September 30, 2014, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 13,428	\$ 26,039	\$ 39,467
Board-designated endowment funds	9,785	-	-	9,785
Endowment funds at end of year	\$ 9,785	\$ 13,428	\$ 26,039	\$ 49,252

Changes in endowment funds for the fiscal year ended September 30, 2014, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment funds at beginning of the year	\$ 9,114	\$ 15,273	\$ 25,789	\$ 50,176
Investment return:				
Investment income, net	170	704	-	874
Change in unrealized gains and losses	501	2,175	-	2,676
Total investment return	671	2,879	-	3,550
Contributions	-	353	131	484
Appropriation of endowment assets for expenditures	-	(4,958)	-	(4,958)
Other changes:				
Transfers to permanently restricted endowment	-	(119)	119	-
Endowment funds at end of year	\$ 9,785	\$ 13,428	\$ 26,039	\$ 49,252

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

9. Endowments (continued)

From time to time, the fair value of assets associated with individual donor-restricted endowments funds may fall below the level fund of the corpus that UPMIFA requires WCHNF to retain as a fund of perpetual duration. These deficiencies result from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Directors. There was \$151 in deficiencies of this nature which are reported in unrestricted net assets as of September 30, 2015 (none at September 30, 2014).

Also included within permanently restricted net assets is \$7,006 and \$7,758 of beneficial interests in trusts held by others as of September 30, 2015 and 2014, respectively.

10. Related Party Transactions

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

	September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Western Connecticut Health Network Affiliates, Inc.	\$ 123	\$ 402
NHA	5,171	558
Norwalk Hospital Foundation	5	18
Norwalk Hospital Physicians & Surgeons	14	—
SWC Corporation	(9)	—
Eastern New York Medical Services, P.C.	(7)	(178)
WCHNF	492	2,988
Western Connecticut Home Care, Inc.	500	322
Western Connecticut Health Network, Inc.	5	144
Western Connecticut Medical Group, Inc.	—	(1,102)
	<u>\$ 6,294</u>	<u>\$ 3,152</u>

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Related Party Transactions (continued)

The Hospital earned income from related parties as follows:

	Year Ended September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Western Connecticut Health Network Affiliates, Inc.	\$ 135	\$ 126
Western Connecticut Medical Group, Inc.	2,320	2,255
NHA	447	—
WCHNF	81	92
	<u>\$ 2,983</u>	<u>\$ 2,473</u>

The Hospital paid expenses to related parties as follows:

	Year Ended September 30	
	2015	2014
Western Connecticut Health Network Affiliates, Inc.	\$ 509	\$ 509
Western Connecticut Medical Group, Inc.	67,706	60,754
WCHNF	56	56
	<u>\$ 68,271</u>	<u>\$ 61,319</u>

In 2015 and 2014, respectively, the Hospital transferred net assets of \$30,353 and \$44,422 to the Network primarily relating to funding the Hospital made to the defined benefit pension plan, transfer of New Milford Hospital pension plan obligation and assets as a result of the merger with the Network plan, benefits paid on the Network's behalf and to fund WCMG. In 2015 and 2014, respectively, WCHNF transferred net assets of \$11,877 and \$22,085 to the Hospital relating to restricted funds appropriated for spending.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

11. Commitments and Contingencies

Various lawsuits and claims arising in the normal course of operations are pending or are in progress against the Hospital. While the outcomes of the lawsuits and claims cannot be determined at this time, management believes that any loss that may arise from these lawsuits and claims will not have a material adverse effect on the financial position or on the net assets of the Hospital.

The Hospital has received requests for information from governmental authorities relating to, among other things, patient billings. These requests relate to compliance with certain laws and regulations. Management is cooperating with these governmental authorities in their information requests and ongoing investigations. While management does not believe that any of these inquiries or investigations will result in a material future loss, the ultimate results of these inquiries and investigations, including the impact on the Hospital, cannot be determined at this time.

Workers' Compensation Insurance

The Hospital is self-insured for workers' compensation benefits. Estimated liabilities of \$7,064 and \$6,589, using a discount rate of 3.5% and 5.6%, have been accrued as of September 30, 2015 and 2014, respectively, based on expected future payments pertaining to such years and are included in accrued pension liabilities and other in the accompanying consolidated balance sheets.

Operating Leases

The Hospital leases property and equipment under noncancelable operating leases that expire in various years through 2023. Certain leases may be renewed at the end of their term.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

11. Commitments and Contingencies (continued)

Future minimum payments under noncancelable operating leases, with initial terms of one year or more consisted of the following at September 30, 2015:

	<u>Operating Lease Payments</u>
2016	\$ 8,351
2017	7,055
2018	6,671
2019	5,504
2020	4,233
Thereafter	9,146
	<u>\$ 40,960</u>

Rent expense was \$8,499 and \$8,749 for the years ended September 30, 2015 and 2014, respectively, and is included within supplies and other in the accompanying consolidated statements of operations. Rental revenue for 2015 and 2014 was approximately \$3,424 and \$3,351, respectively, and is included within other operating revenue in the accompanying consolidated statements of operations.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

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

	Year Ended September 30	
	2015	2014
(Increase) decrease in operating assets:		
Accounts receivable, net	\$ (27,714)	\$ (24,586)
Inventories	666	(573)
Prepaid expenses and other	6,597	(10,057)
Bond issuance costs, net	834	489
	<u>(19,617)</u>	<u>(34,727)</u>
Increase (decrease) in operating liabilities:		
Accounts payable	(277)	40
Interest payable	51	84
Payroll-related accruals	2,955	3,254
Due to third-party payors	798	6,750
Other accrued expenses	(798)	206
	<u>2,729</u>	<u>10,334</u>
Change in working capital other than cash and cash equivalents	<u>\$ (16,888)</u>	<u>\$ (24,393)</u>

13. Functional Expenses

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

	Year Ended September 30	
	2015	2014
	<i>(As Adjusted)</i>	
Health care services	\$ 512,911	\$ 491,435
General and administrative	110,039	106,577
	<u>\$ 622,950</u>	<u>\$ 598,012</u>

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

14. Other Operating Revenue

Other operating revenue consisted of the following:

	Year Ended September 30	
	2015	2014
Captive malpractice insurance premiums	\$ 12,361	\$ 12,429
Captive investment income	938	1,273
Rental income	3,424	3,351
Education	2,401	1,642
Grants	2,939	3,454
Research	641	478
EHR incentive payments	66	753
Other income	1,046	1,139
	<u>\$ 23,816</u>	<u>\$ 24,519</u>

15. Subsequent Events

The Hospital and its subsidiary have performed an evaluation of subsequent events through January 28, 2016, the date the consolidated financial statements were issued.

In November 2015, Western Connecticut Health Network Investments, LLC (WCHN Investments), a wholly owned subsidiary of WCHN, was formed for the purpose of pooling the long-term investments of NHA, Norwalk Hospital Foundation, the Hospital, and WCHNF. On December 31, 2015, the long term investments of the Hospital were contributed to WCHN Investments. In exchange, the Hospital received pro rata share of the combined investments and investment returns of WCHN Investments. WCHN Investments became a member of the WCHN Obligated Group.

No other events have occurred that require disclosure in or adjustment to the accompanying consolidated financial statements.

Supplementary Information

The Danbury Hospital and Subsidiary

Consolidating Balance Sheet
(In Thousands)

	September 30, 2015			
	The Danbury Hospital	Western Connecticut Health Network Insurance Co., Ltd.	Adjustments and Eliminations	Total
Assets				
Current assets:				
Cash and cash equivalents	\$ 21,083	\$ 611	\$ -	\$ 21,694
Assets limited as to use, current portion	1,868	5,500	-	7,368
Patient accounts receivable, less allowance for uncollectible accounts of approximately \$13,937 in 2015	76,938	-	-	76,938
Due from related parties	6,402	-	(108)	6,294
Inventories	10,950	-	-	10,950
Prepaid expenses and other	6,399	10,839	-	17,238
Total current assets	123,640	16,950	(108)	140,482
Assets limited as to use:				
Investments held by WCHNIC	-	115,882	-	115,882
Total noncurrent assets limited as to use	-	115,882	-	115,882
Investments	166,957	-	-	166,957
Other assets	2,801	-	-	2,801
Investment in Western Connecticut Health Network Insurance Co., Ltd.	53,694	-	(53,694)	-
Interest in Western Connecticut Health Network Foundation, Inc.	92,378	-	-	92,378
Property, plant and equipment:				
Land and land improvements	12,308	-	-	12,308
Buildings and building improvements	511,120	-	-	511,120
Equipment and other	306,225	-	-	306,225
Construction in progress (estimated cost to complete at September 30, 2015: \$9,259)	16,766	-	-	16,766
	846,419	-	-	846,419
Less accumulated depreciation	452,258	-	-	452,258
	394,161	-	-	394,161
Bond issuance costs, net	3,777	-	-	3,777
Total assets	\$ 837,408	\$ 132,832	\$ (53,802)	\$ 916,438

The Danbury Hospital and Subsidiary

Consolidating Balance Sheet (continued)
(In Thousands)

	September 30, 2015			
	The Danbury Hospital	Western Connecticut Health Network Insurance Co., Ltd.	Adjustments and Eliminations	Total
Liabilities and net assets				
Current liabilities:				
Accounts payable	\$ 35,981	\$ 72	\$ -	\$ 36,053
Payroll-related accruals	36,985	-	-	36,985
Due to third-party payors	18,232	-	-	18,232
Current portion due to related parties	-	108	(108)	-
Interest payable	1,842	-	-	1,842
Other accrued expenses	2,700	-	-	2,700
Current portion of long-term debt	1,580	-	-	1,580
Total current liabilities	97,320	180	(108)	97,392
Self-insurance liabilities	-	78,958	-	78,958
Accrued pension liabilities and other	20,082	-	-	20,082
Long-term debt, less current portion	243,270	-	-	243,270
Total liabilities	360,672	79,138	(108)	439,702
Net assets:				
Share capital	-	12	(12)	-
Additional paid in capital	-	12,863	(12,863)	-
Unrestricted	406,110	40,819	(40,819)	406,110
Temporarily restricted	36,051	-	-	36,051
Permanently restricted	34,575	-	-	34,575
Total net assets	476,736	53,694	(53,694)	476,736
Total liabilities and net assets	\$ 837,408	\$ 132,832	\$ (53,802)	\$ 916,438

The Danbury Hospital and Subsidiary

Consolidating Statement of Operations
(In Thousands)

	Year Ended September 30, 2015			
	The Danbury Hospital	Western Connecticut Health Network Insurance Co., Ltd.	Adjustments and Eliminations	Total
Unrestricted revenues:				
Net patient service revenue	\$ 614,030	\$ -	\$ -	\$ 614,030
Provision for uncollectible accounts	21,154	-	-	21,154
Net patient service revenue, less provision for uncollectible accounts	592,876	-	-	592,876
Net assets released from restrictions	6,073	-	-	6,073
Other operating revenue	10,518	23,409	(10,111)	23,816
	609,467	23,409	(10,111)	622,765
Expenses:				
Salaries, benefits and fees	357,097	-	-	357,097
Supplies and other	188,666	398	(10,111)	178,953
Insurance	-	9,682	-	9,682
Depreciation and amortization	45,374	-	-	45,374
Interest	7,442	-	-	7,442
State of Connecticut Hospital Tax	24,402	-	-	24,402
	622,981	10,080	(10,111)	622,950
(Loss) income from operations before loss on extinguishment of long-term debt	(13,514)	13,329	-	(185)
Loss on extinguishment of long-term debt	(1,357)	-	-	(1,357)
(Loss) income from operations	(14,871)	13,329	-	(1,542)
Nonoperating gains and (losses):				
Investment income, net	4,223	-	-	4,223
Change in unrealized gains and losses on investments	(6,686)	(1,071)	1,071	(6,686)
Change in equity interest in unrestricted net assets of the Western Connecticut Health Network Foundation, Inc.	(1,601)	-	-	(1,601)
Change in investment in WCHNIC	13,329	-	(13,329)	-
	9,265	(1,071)	(12,258)	(4,064)
Deficiency (excess) of revenues over expenses	\$ (5,606)	\$ 12,258	\$ (12,258)	\$ (5,606)

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