

**Milford Health & Medical, Inc.
and Subsidiaries**

Consolidated Financial Statements and
Supplementary Information

September 30, 2015 and 2014



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Milford Health & Medical, Inc. and Subsidiaries

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Independent Auditors' Report

The Board of Directors
Milford Health & Medical, Inc. and Subsidiaries

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Milford Health & Medical, Inc. and Subsidiaries (the "Company"), which comprise the consolidated balance sheet 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 Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Seaside Indemnity Alliance Company, Ltd. ("SIAC"), a wholly-owned subsidiary, whose statements reflect total assets constituting 12 percent of consolidated total assets at September 30, 2015 and 2014, and 10 percent and 11 percent, respectively, of consolidated liabilities at September 30, 2015 and 2014. 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 SIAC, 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 of America. Those standards require that we plan and perform the audits 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 audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Milford Health & Medical, Inc. and Subsidiaries as of September 30, 2015 and 2014, and the consolidated results of its operations and changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Supplementary Information

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

Baker Tilly Viechow Krause, LLP

New York, New York
February 29, 2016

Milford Health & Medical, Inc. and Subsidiaries

 Consolidated Balance Sheet
 September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>		<u>2015</u>	<u>2014</u>
Assets			Liabilities and Net Assets (Deficit)		
Current Assets			Current Liabilities		
Cash and cash equivalents	\$ 1,974,260	\$ 7,667,186	Current maturities of long-term debt	\$ 150,501	\$ 142,366
Short-term investments	3,538,211	112,417	Accounts payable	6,840,233	7,255,878
Patient accounts receivable, net of estimated allowance for doubtful accounts of approximately \$3,204,000 in 2015 and \$3,144,000 in 2014	9,571,176	9,919,854	Accrued salaries, wages and vacation	5,996,188	6,989,049
Inventories	775,631	772,809	Estimated third-party payor settlements	1,101,627	1,575,365
Prepaid expenses and other current assets	<u>1,077,563</u>	<u>1,159,190</u>	Other current liabilities	<u>2,029,560</u>	<u>1,964,014</u>
Total current assets	16,936,841	19,631,456	Total current liabilities	16,118,109	17,926,672
Investments	3,092,074	5,052,099	Long-Term Debt	14,342,431	12,492,523
Assets Whose Use is Limited	6,090,992	5,169,001	Insured Claims Liabilities, Net of Current Portion	1,538,748	1,383,772
Property, Plant, and Equipment			Self-Insured Professional Claims Liabilities	4,705,170	3,959,117
Land and land improvements	6,652,200	6,652,200	Accrued Pension and Other Liabilities	<u>38,221,539</u>	<u>23,770,924</u>
Building and building improvements	23,792,212	23,787,280	Total liabilities	<u>74,925,997</u>	<u>59,533,008</u>
Equipment	36,548,015	35,152,583			
Construction in progress	183,601	216,038	Net Assets (Deficit)		
	<u>67,176,028</u>	<u>65,808,101</u>	Unrestricted	(14,756,915)	5,129,446
Less accumulated depreciation	(34,212,577)	(31,844,774)	Temporarily restricted	840,477	840,477
	<u>32,963,451</u>	<u>33,963,327</u>	Permanently restricted	<u>673,763</u>	<u>673,763</u>
Investment in Affiliates	576,739	304,400	Total net assets (deficit)	<u>(13,242,675)</u>	<u>6,643,686</u>
Insured Claims Receivable, Net of Current Portion	<u>2,023,225</u>	<u>2,056,411</u>	Total liabilities and net assets (deficit)	<u>\$ 61,683,322</u>	<u>\$ 66,176,694</u>
Total assets	<u>\$ 61,683,322</u>	<u>\$ 66,176,694</u>			

See notes to consolidated financial statements

Milford Health & Medical, Inc. and SubsidiariesConsolidated Statement of Operations and Changes in Net Assets
Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Operating Revenues		
Patient service revenue	\$ 68,798,000	\$ 73,810,727
Provision for bad debts	<u>(3,898,291)</u>	<u>(5,785,341)</u>
Net patient service revenue (less provision for bad debts)	64,899,709	68,025,386
Inpatient Rehabilitation Unit income, net	2,898,446	-
Other revenue	<u>1,749,281</u>	<u>2,438,403</u>
Total operating revenues	<u>69,547,436</u>	<u>70,463,789</u>
Operating Expenses		
Salaries and wages	35,312,951	38,732,103
Employee benefits	10,890,607	10,103,835
Supplies and other	25,568,949	26,425,644
Provision for non-patient bad debts	2,374,474	2,880,503
Depreciation and amortization	2,766,285	2,989,243
Interest	<u>502,550</u>	<u>452,267</u>
Total operating expenses	<u>77,415,816</u>	<u>81,583,595</u>
Operating loss	<u>(7,868,380)</u>	<u>(11,119,806)</u>
Nonoperating Income, Net		
Investment income	1,632,871	1,712,782
Contributions	<u>150,308</u>	<u>156,498</u>
Net nonoperating income	<u>1,783,179</u>	<u>1,869,280</u>
Change in Unrealized Gains and Losses on Investments	<u>(571,356)</u>	<u>(422,199)</u>
Expenses in excess of revenues	<u>\$ (6,656,557)</u>	<u>\$ (9,672,725)</u>

See notes to consolidated financial statements

Milford Health & Medical, Inc. and Subsidiaries

Consolidated Statement of Operations and Changes in Net Assets

Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Unrestricted Net Deficit (Continued)		
Expenses in excess of revenues	\$ (6,656,557)	\$ (9,672,725)
Pension liability adjustment	(13,236,780)	(1,655,986)
Transfers to affiliates	-	(529,885)
Net assets released from restrictions used for purchases of property and equipment	<u>6,976</u>	<u>92,074</u>
Change in unrestricted net assets	<u>(19,886,361)</u>	<u>(11,766,522)</u>
Temporarily Restricted Net Assets		
Investment income	6,976	158,041
Net assets released from restrictions	<u>(6,976)</u>	<u>(92,074)</u>
Change in temporarily restricted net assets	<u>-</u>	<u>65,967</u>
Decrease in net assets	(19,886,361)	(11,700,555)
Net Assets, Beginning	<u>6,643,686</u>	<u>18,344,241</u>
Net Assets (Deficit), Ending	<u><u>\$ (13,242,675)</u></u>	<u><u>\$ 6,643,686</u></u>

See notes to consolidated financial statements

Milford Health & Medical, Inc. and Subsidiaries

Consolidated Statement of Cash Flows

Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Cash Flows from Operating Activities		
Decrease in net assets	\$ (19,886,361)	\$ (11,700,555)
Adjustments to reconcile decrease in net assets net cash used in operating activities:		
Depreciation	2,766,285	2,989,243
Provision for bad debts	6,272,765	8,665,844
Change in realized gains and unrealized losses on investments	589,374	(177,440)
Pension liability adjustment	13,236,780	1,655,986
Transfers to affiliates	-	529,885
Changes in assets and liabilities:		
Patient accounts receivable	(3,549,613)	(5,333,466)
Inventories	(2,822)	115,051
Prepaid expenses and other current assets	(2,292,847)	(420,605)
Accounts payable	(415,645)	1,744,500
Accrued salaries, wages and vacation	(992,861)	(162,983)
Other liabilities	1,279,381	(1,931,013)
Estimated third-party payor settlements	(473,738)	528,445
Insured claims receivable, net	188,162	2,259,758
Self-insured professional claims liabilities	746,053	(3,855,777)
Net cash used in operating activities	<u>(2,535,087)</u>	<u>(5,093,127)</u>
Cash Flows from Investing Activities		
Net purchases of property and equipment	(1,766,409)	(1,620,177)
Change in investments in affiliates	(272,339)	43,750
(Increase) decrease in investments and assets whose use is limited	<u>(2,977,134)</u>	<u>5,826,918</u>
Net cash (used in) provided by investing activities	<u>(5,015,882)</u>	<u>4,250,491</u>
Cash Flows from Financing Activities		
Proceeds from issuance of note payable	2,000,000	6,000,000
Transfers to affiliates	-	(529,885)
Repayment of long-term debt	<u>(141,957)</u>	<u>(133,335)</u>
Net cash provided by financing activities	<u>1,858,043</u>	<u>5,336,780</u>
Net (decrease) increase in cash and cash equivalents	(5,692,926)	4,494,144
Cash and Cash Equivalents, Beginning	<u>7,667,186</u>	<u>3,173,042</u>
Cash and Cash Equivalents, Ending	<u>\$ 1,974,260</u>	<u>\$ 7,667,186</u>
Supplementary Disclosure of Cash Flow Information		
Interest paid	<u>\$ 502,550</u>	<u>\$ 452,267</u>

See notes to consolidated financial statements

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2015 and 2014

1. Organization and Accounting Policies

The accompanying consolidated financial statements include the accounts of Milford Health & Medical Inc. (the "Company"), a tax-exempt entity incorporated under the general statutes of the state of Connecticut. The Company's tax-exempt subsidiaries include Milford Hospital, Incorporated (the "Hospital"), an acute care hospital; Milford Hospital Foundation, Inc.; Home Care Plus, Inc.; and Milford Health Care Services, Inc. The Company's for-profit subsidiaries include Torry Corporation, Seabridge, Inc., Seaside Indemnity Alliance Company, Ltd. ("SIAC"); and Milford Medical Lab, Inc. All of the subsidiaries are incorporated under the general statutes of the state of Connecticut, except for SIAC. All material intercompany transactions have been eliminated.

SIAC was incorporated on May 10, 2013, under the laws of the Cayman Islands and is wholly owned by the Company. SIAC obtained a Cayman Islands unrestricted class B(i) insurance license on June 6, 2013, and commenced to write certain of its business on July 1, 2013. SIAC's activities are the direct insurance of the Hospital's professional and comprehensive general liability risks together with the physician professional liability risks of certain of the Hospital's affiliated physicians.

Financial Transaction and Liquidity

For the years ended September 30, 2015 and 2014, the Company had operating losses of approximately \$7.8 and \$11.1 million, respectively. The Company's continued existence is dependent upon future operations in which cash revenue exceeds expenses to provide for the maintenance of adequate working capital. Management's plans for dealing with the historical and ongoing effects of recently declining operations results are focused on cost reduction, revenue enhancement, and shared or interested services with other health care providers.

In September 2014, the Company entered into an agreement with another health care provider in which the provider utilizes beds at the Company under a lease arrangement and the provider furnished an \$8.0 million term loan to the Company in order to provide it with liquidity. The Company obtained a waiver of its Days Cash on Hand covenant through October 1, 2016. See Note 5.

Estimates and Assumptions

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities such as estimated uncollectible accounts for patient accounts receivable, insurance claims liabilities and receivables, estimated impairment of long-lived assets and estimated receivables from and payables to third-party reimbursement agencies, and disclosure of contingent assets and contingent liabilities at the date of the financial statements. The allowance for doubtful accounts, impairment of long-lived assets, insurance claims liabilities and receivables, and the estimated receivables from and payables to third-party reimbursement agencies, among other accounts, require significant use of estimates. Estimates also affect the reported amounts of revenues and expenses during the reported period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Regulatory Matters

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

Cash and Cash Equivalents and Short-Term Investments

The Company considers all highly-liquid investments with a maturity of three months or less, when purchased, to be cash equivalents. Short-term investments consist of cash and cash equivalents. Cash and cash equivalents are maintained with domestic financial institutions with deposits that exceed federally insured limits and therefore, bear a risk of loss.

Inventories

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

Fair Value of Financial Instruments

The carrying value of financial instruments in the accompanying consolidated balance sheets as of September 30, 2015 and 2014, approximate fair value based on current market conditions. The fair value of each financial instrument is disclosed in the respective notes and in Note 4.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value at the balance sheet date. Investment income or loss (including interest, dividends, realized gains and losses, and change in unrealized gains and losses) is included in the determination of expenses in excess of revenues unless the income or loss is restricted by donor or law. Assets temporarily restricted (by donor) are recorded at fair value at the date of donation, which is then considered cost.

Alternative investments (not readily marketable assets) are stated in the accompanying balance sheet based upon net asset values derived from the application of the equity method of accounting. Individual investment holdings within the alternative investments may, in turn, include investments in both nonmarketable and market-traded securities. Financial information used by the Company to evaluate its alternative investments is prepared by the investment manager or general partner and includes fair value valuations that may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. Generally, fair value reflects net contributions to the investee and an ownership share of realized and unrealized investment income and expenses. The investments may indirectly expose the Company to securities lending, short sales of securities, and trading in futures and forwards contracts, options, swap contracts, and other derivative products. While these financial instruments may contain varying degrees of risk, the Company's risk with respect to such transactions is limited to its capital balance in each investment. The financial statements of the investees are audited annually by independent auditors.

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Notes to Consolidated Financial Statements

September 30, 2015 and 2014

There is uncertainty in determining values of alternative investments arising from factors such as lack of active markets (primary and secondary), lack of transparency into underlying holdings, and time lags associated with reporting by the investee companies. As a result, there is at least a reasonable possibility that estimates will change.

Investment income, including realized gains and changes in unrealized gains and losses on investments, interest, and dividends, is included in nonoperating income unless the income or loss is restricted by the donor or law. The cost of securities sold is based on the specific identification method. The financial statements of the investees are audited annually by independent auditors.

The alternative investments include certain liquidity restrictions that may require 90 days advance notice for redemptions, and there are remaining commitments to the alternative investment funds of \$97,500 as of September 30, 2015.

Assets Limited as to Use

Assets limited as to use primarily consist of interest bearing deposits in banks which have been set aside by the Board of Directors (the "Board") for future capital improvements or purchases of equipment and designated as collateral for a construction loan, and investments held by SIAC for funding of self-insured professional liability claims. The Board retains control of funds it has set aside and may, at its discretion, subsequently use these funds for other purposes.

Patient Accounts Receivable

Patient accounts receivable result from health care services provided by the Company. Additions to the allowance for doubtful accounts result from the provision for bad debts. Accounts written off as uncollectible are deducted from the allowance for doubtful accounts. The amount of the allowance for doubtful accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in Medicare and Medicaid health care coverage, and other collection indicators. See Note 2 for additional information relative to third-party payor programs.

The Company's primary concentration of credit risk is patient accounts receivable, which consists of amounts owed by various governmental agencies, insurance companies, and private patients. The Company 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, before allowances for doubtful accounts, include 42% and 43% for Medicare, and 7% and 8% for Medicaid for the years ended September 30, 2015 and 2014, respectively.

Property, Plant, and Equipment

Property, plant, and equipment is stated on the basis of cost. Depreciation of property, plant, and equipment is provided using the straight-line method over their estimated useful lives of the related assets as follows:

Building and improvements	5 - 50 years
Equipment	3 - 25 years

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Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If long-lived assets are deemed to be impaired, the impairment loss to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value. As a result of declining operating results, the Company performed an evaluation of long-lived assets. The Company determined that the long-lived assets are not impaired at September 30, 2015 or 2014.

During January 2014, the Company received approval for grant funding in the amount of \$2,000,000 from the State of Connecticut Department of Public Health to purchase medical and computer equipment to meet the clinical needs of its patients. As of September 30, 2015, the Company has received approximately \$1,854,000 for funds used to purchase equipment.

Self-Insured Professional Liability Claims

Self-insured professional claims liabilities have been provided for using management's estimates on the basis of claims records and an independent actuarial review and include an amount for the adverse development of reported claims. Adjustments to the estimate of the liability for losses are reflected in earnings for the period in which the adjustment is determined.

Restricted Net Assets

Temporarily restricted net assets are those where use by the Company has been limited by donors to a specific time frame or purpose. All of the Company's temporarily restricted net assets are restricted for capital expenditures. Permanently restricted net assets are amounts to be held in perpetuity, the income of which can be used for capital expenditures.

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 if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are included in nonoperating income in the accompanying consolidated statement of operations and changes in net assets.

Expenses in Excess of Revenues

The accompanying consolidated statement of operations and changes in net assets include expenses in excess of revenues as the performance indicator. Changes in unrestricted net assets, which are excluded from expenses in excess of revenues, include 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 liability adjustment.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Income Taxes

The Company and its subsidiaries are not-for-profit, with the exception of Seabridge Inc., Milford Medical Lab, Inc., Torry Corporation, and SIAC, as described in Section 501(c)(3) of the Internal Revenue Code (the "Code"), and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code and from the state of Connecticut and local income taxes.

The Hospital has a net operating loss carryforward from unrelated business activities of approximately \$6,045,000. A deferred tax asset for these losses of approximately \$2,418,000 is offset by a corresponding valuation allowance of the same amount. Operating loss carryforwards will begin to expire in four years.

As of September 30, 2015, Seabridge, Inc. and its subsidiary had consolidated net operating loss carryforwards of approximately \$7,800,000. A deferred tax asset for these losses of approximately \$3,120,000 is offset by a corresponding valuation allowance of the same amount. Operating loss carryforwards will begin to expire in four years.

As of September 30, 2015, Torry Corporation has a net operating loss carryforward of approximately \$1,426,000. A deferred tax asset for these losses of approximately \$570,000 is offset by a corresponding valuation allowance of the same amount. Tax provisions and related liabilities for Seabridge, Inc. and Milford Medical Lab, Inc. are not material to the consolidated financial statements. Operating loss carryforwards will begin to expire in eight years.

As of September 30, 2015, SIAC presently has no taxation imposed on income or premiums by the government of the Cayman Islands. If any form of taxation were to be enacted, the Company has been granted an exemption there until May 10, 2033.

Subsequent Events

The Company evaluates the impact of subsequent events, which are events that occur after the balance sheet date but before the consolidated financial statements are issued, for potential recognition or disclosure in the consolidated financial statements as of the balance sheet date. For the year ended September 30, 2015, the Company evaluated subsequent events through February 29, 2016, which is the date the consolidated financial statements were issued.

Reclassifications

Certain reclassifications have been made to the 2014 balances previously reported to conform to the current year presentation.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2015 and 2014

2. Revenues from Services to Patients and Charity Care

The following table summarizes net revenues from services to patients:

	<u>2015</u>	<u>2014</u>
Gross revenues from services to patients	\$ 208,174,705	\$ 204,473,380
Deductions:		
Allowances	139,131,351	130,089,233
Charity care	245,354	573,420
	<u>139,376,705</u>	<u>130,662,653</u>
Patient service revenue (net of contractual allowances and discounts)	68,798,000	73,810,727
Provision for bad debts	<u>(3,898,291)</u>	<u>(5,785,341)</u>
Net patient service revenue (less provision for bad debts)	<u>\$ 64,899,709</u>	<u>\$ 68,025,386</u>

Patient revenues from services to patients for the years ended September 30, 2015 and 2014, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources based on primary insurance designation, are as follows:

	<u>2015</u>	<u>2014</u>
Third-party payors	\$ 65,747,010	\$ 68,901,474
Self-pay	<u>3,050,990</u>	<u>4,909,253</u>
Total all payors	<u>\$ 68,798,000</u>	<u>\$ 73,810,727</u>

Deductibles and copayments under third-party payment programs within the third-party payor amount above are the patient's responsibility and the Hospital considers these amounts in its determination of the provision for bad debts based on collection experience.

Accounts receivable are also reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for payors who are known to be having financial difficulties that make the realization of amounts due unlikely).

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For receivables associated with self-pay patients which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Company records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between discounted rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Company's allowance for doubtful accounts totaled approximately \$3,204,000 and \$3,344,000 at September 30, 2015 and 2014, respectively. The allowance for doubtful accounts for self-pay patients was approximately 81.6% and 63.7% of self-pay accounts receivable as of September 30, 2015 and 2014, respectively. Overall, the total of self-pay discounts and write-offs has not changed significantly for the year ended September 30, 2015. The Company has not experienced significant changes in write-off trends.

During 2015 and 2014, the Company's net revenues from services to patients were 45% and 44% from Medicare, 8% and 9% from Medicaid, and 12% and 14% from Blue Cross (governmental payors include managed Medicare and Medicaid business), 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 Company believes that it is in compliance with all applicable laws and regulations, and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Company.

Patient accounts receivable and revenues are recorded when patient services are performed. The Company has agreements with certain third-party payors, including health maintenance organizations that provide for payments to the Company at amounts different from the Company's established billing rates. These differences are accounted for as allowances. Under these agreements, the Company receives reimbursement based on a number of different arrangements, including fee-for-service payments.

Net revenues from services to patients 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. Revenue under third-party payor agreements is subject to audit and retroactive adjustments. 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. Retroactive adjustments related to settlements with third-party payors increased net patient service revenue by approximately \$216,000 in 2015 and decreased net patient service revenue by approximately \$50,000 in 2014.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2015 and 2014

The Company 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 Company. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Company utilizes the generally recognized poverty income levels for the state of Connecticut, but also includes certain cases where incurred charges are significant when compared to income. These charges are not included in net revenues from services to patients for financial reporting purposes.

The estimated cost of charity care provided was \$90,578 and \$243,887 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

Investments are comprised of the following at September 30:

	<u>2015</u>	<u>2014</u>
Cash and cash equivalents	\$ 3,883,354	\$ 1,599,541
Government bonds	624,309	535,744
Corporate bonds	773,484	934,766
Fixed income mutual funds	139,511	326,285
Equity mutual funds	270,101	381,306
Equities	163,911	170,281
Exchange-traded funds	6,240	-
Alternative investments	769,375	1,216,593
	<u>6,630,285</u>	<u>5,164,516</u>
Less short-term investments	<u>3,538,211</u>	<u>112,417</u>
Long-term investments	<u>\$ 3,092,074</u>	<u>\$ 5,052,099</u>

Assets limited as to use are comprised of the following at September 30:

	<u>2015</u>	<u>2014</u>
Cash and cash equivalents	\$ 1,015,429	\$ 1,071,100
Certificates of deposit	29,283	29,171
Government bonds	1,652,375	960,086
Corporate bonds	1,132,690	599,964
Fixed income mutual funds	282,457	726,978
Equity mutual funds	556,247	494,552
Equities	9,271	9,811
Exchange-traded funds	133,985	141,783
Alternative investments	1,279,255	1,135,556
	<u>\$ 6,090,992</u>	<u>\$ 5,169,001</u>

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2015 and 2014

The composition of assets limited as to use at September 30 is as follows:

	<u>2015</u>	<u>2014</u>
Internally designated	\$ 144,139	\$ 145,905
Collateral for a construction loan	1,000,000	1,000,000
Investments held by SIAC	4,273,090	3,349,333
Permanently restricted	673,763	673,763
Total	<u>\$ 6,090,992</u>	<u>\$ 5,169,001</u>

The components of investment earnings, included in nonoperating income, include the following for the years ended September 30:

	<u>2015</u>	<u>2014</u>
Interest income	\$ 1,312,702	\$ 1,010,271
Dividend income	345,326	316,919
Realized gains	(15,167)	599,639
Other	(9,990)	(214,047)
Investment income, net	1,632,871	1,712,782
Change in unrealized gains and losses on investments	<u>(571,356)</u>	<u>(422,199)</u>
Total	<u>\$ 1,061,515</u>	<u>\$ 1,290,583</u>

4. Fair Value of Financial Instruments

As defined in ASC 820-10, *Fair Value Measurement - Overall*, fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, ASC 820-10 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

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

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

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

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 Company utilizes 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.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2015 and 2014

Financial assets carried at fair value in the accompanying consolidated balance sheets, excluding assets invested in the Company's defined benefit pension plan, are classified in the table below in one of the three categories described above:

	2015			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 4,898,783	\$ -	\$ -	\$ 4,898,783
Certificates of deposit	29,283	-	-	29,283
Government bonds	-	2,276,684	-	2,276,684
Corporate bonds	-	1,906,174	-	1,906,174
Fixed income mutual funds	421,968	-	-	421,968
Equity mutual funds	826,348	-	-	826,348
Equities	173,182	-	-	173,182
Exchange-traded funds	140,225	-	-	140,225
Alternative investments	-	1,900,432	148,198	2,048,630
Total	\$ 6,489,789	\$ 6,083,290	\$ 148,198	\$ 12,721,277

	2014			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 2,670,641	\$ -	\$ -	\$ 2,670,641
Certificates of deposit	29,171	-	-	29,171
Government bonds	-	1,495,830	-	1,495,830
Corporate bonds	-	1,534,730	-	1,534,730
Fixed income mutual funds	1,053,263	-	-	1,053,263
Equity mutual funds	875,858	-	-	875,858
Equities	180,092	-	-	180,092
Exchange-traded funds	141,783	-	-	141,783
Alternative investments	-	2,011,086	341,063	2,352,149
Total	\$ 4,950,808	\$ 5,041,646	\$ 341,063	\$ 10,333,517

Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is based upon 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.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2015 and 2014

5. Note Payable and Debt

On September 2, 2014, the Company entered into a Master Agreement with another health care provider to provide a framework for implementing programs in a manner that is consistent with the charitable mission of each organization and the communities it serves. Under the terms of the agreement, the health care provider will utilize beds at the Company under a lease arrangement to provide inpatient rehabilitation services to its patients and will furnish an \$8,000,000 term loan to the Company. The Company had an outstanding balance on the loan of \$8,000,000 at September 30, 2015 and \$6,000,000 at September 30, 2014. The term loan bears interest of 6.5%, which is a deduction of the amount due under the Inpatient Rehabilitation Unit ("IRU") Lease. The principal balance of the term loan is payable to the lender in two equal annual installments on September 30, 2018 and 2019.

The term loan is collateralized by certain property owned by the Company.

In addition to the Master Agreement, the Company entered into an IRU Lease Agreement and an IRU Services Agreement. The details of those agreements are as follows:

- IRU Lease Agreement: The term of the IRU Lease Agreement is five years during which time the Company will lease certain beds to the health care provider to be used to provide inpatient rehabilitation services to patients of the health care provider. The lease provides the tenant with two five-year renewal options at the end of each term. Monthly payments (base rent and overhead allocation) to the Company range from \$192,000 to \$280,000 throughout the initial five-year term.
- IRU Services Agreement: The term of the IRU Services Agreement is five years during which time the health care provider will purchase certain clinical services related to those rehabilitation patients at the Company from the Company and certain affiliated physicians. The service agreement provides the Company with two five-year renewal options at the end of each term. Monthly payments to the Company include a fixed monthly fee of approximately \$149,000 and a per-patient-per-day fee of \$238. The monthly fee will increase by 2.75% per year.

The Master Agreement requires the Company to comply with certain financial covenants regarding levels of cash available for operations. If the Company fails to meet such covenants, they are required to provide the health care provider with an action plan related to maintaining certain levels of cash available for operations. If the Company falls below 20 days cash on hand, the health care provider may terminate the agreements, in which case the term loan will be due immediately. The Company obtained a waiver of this covenant through October 1, 2016.

On November 19, 2009, the Company entered into a construction loan with a bank. At September 30, 2015 and 2014, the Company had an unpaid balance of \$6,492,932 and \$6,634,889, respectively. Interest paid during fiscal years 2015 and 2014 amounted to \$417,157 and \$425,306, respectively. A portion of the proceeds of this loan was used to pay off the irrevocable construction mortgage in 2010. The project was completed during fiscal year 2011 and on October 15, 2011, the construction loan was converted to a permanent mortgage bearing interest at a fixed rate of 6.25% over a 25-year term.

The Company's carrying value of debt obligations approximates fair value as of September 30, 2015 and 2014.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2015 and 2014

Future minimum principal payments during each of the next five fiscal years, and in the aggregate, were as follows at September 30, 2015:

2016	\$ 150,501
2017	161,473
2018	172,008
2019	4,183,230
2020	4,194,154
Thereafter	<u>5,631,566</u>
	<u>\$ 14,492,932</u>

6. Pension Plan

The Hospital has a defined benefit pension plan (the "Plan") covering substantially all of its employees. Plan benefits are based on years of service and the employee's compensation. Plan participants will vest in their benefits on a percentage basis with years of service.

Effective August 26, 2009, the Hospital's executive committee of the Board of Directors adopted a resolution to freeze the Plan for non-union employees effective December 31, 2009. Effective January 24, 2012, the Hospital's executive committee of the Board of Directors adopted a resolution to freeze the Plan for nursing union employees effective January 31, 2012.

The Hospital recognizes the funded status (i.e., the difference between the fair value of Plan assets and the projected benefit obligation) of the Plan in its balance sheet.

Net unrecognized actuarial losses at the reporting date will be subsequently recognized in the future as net periodic pension credit pursuant to the Hospital's accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension credit in the same periods will be recognized as a component of unrestricted net assets.

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

	<u>2015</u>	<u>2014</u>
Unrecognized actuarial loss	<u>\$ (30,299,068)</u>	<u>\$ (17,062,288)</u>

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2015 and 2014

The following table presents a reconciliation of the beginning and ending balances of the Plan's projected benefit obligation and the fair value of Plan assets, as well as the funded status of the Plan and accrued pension cost included in the financial statements:

	<u>2015</u>	<u>2014</u>
Changes in benefit obligation:		
Projected benefit obligation, beginning of year	\$ 81,645,368	\$ 81,706,599
Service cost	552,032	535,754
Interest cost	3,705,453	3,748,965
Benefits paid	(6,578,690)	(5,959,465)
Expenses paid	(636,897)	(552,032)
Actuarial losses	6,452,288	2,165,547
	<u>\$ 85,139,554</u>	<u>\$ 81,645,368</u>
Changes in Plan assets:		
Fair value of Plan assets, beginning of year	\$ 64,415,767	\$ 65,869,815
Contributions	-	-
Actual return on Plan assets	(2,516,232)	5,057,449
Benefits paid	(6,578,690)	(5,959,465)
Expenses paid	(636,897)	(552,032)
	<u>\$ 54,683,948</u>	<u>\$ 64,415,767</u>
Funded status of the Plan	<u>\$ (30,455,606)</u>	<u>\$ (17,229,601)</u>
Components of net periodic pension credit:		
Service cost	\$ 552,032	\$ 535,754
Interest cost	3,705,452	3,748,965
Expected return on plan assets	(4,704,119)	(4,818,777)
Net amortization and deferral of actuarial loss	435,860	270,889
	<u>\$ (10,775)</u>	<u>\$ (263,169)</u>

The weighted-average assumptions used to develop net periodic benefit credit, and the projected benefit obligation as of September 30 are as follows:

	<u>2015</u>	<u>2014</u>
Discount rate used for net periodic pension credit	4.45 %	4.65 %
Discount rate used for projected benefit obligation	4.15	4.45
Expected long-term rate of return on plan assets	7.50	7.50
Rate of compensation increase	N/A	N/A

The accumulated benefit obligation at September 30, 2015 and 2014, was \$85,139,554 and \$81,645,368, respectively.

The actuarial losses in 2015 and 2014 are primarily attributed to an increase in the discount rate and change in the mortality table.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2015 and 2014

Plan Assets

To develop the expected long-term rate of return on plan assets assumption, the Hospital considers the historical return and the future expectations for return for each asset class, as well as target allocation of the plan asset portfolio. The Plan's investment objectives are to achieve long-term growth in excess of long-term inflation, and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets over a long-term time horizon. In order to minimize the risk, the Plan aims to minimize the variability in yearly returns. The Plan also aims to diversify its holdings among sectors, industries, and companies. No more than 10% of the Plan's portfolio, excluding U.S. government securities and cash, may be held in an individual company's stocks or bonds, and no more than 20% in a single industry.

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

	<u>2015</u>	<u>2014</u>
Asset category:		
Cash and money market funds	4.1 %	2.6 %
Government bonds	12.5	10.4
Corporate bonds	7.4	6.5
Equities	58.4	62.7
Alternative investments	<u>17.6</u>	<u>17.8</u>
Total	<u>100.0 %</u>	<u>100.0 %</u>

The target allocation for the Plan's assets is 60% equity securities, 30% fixed income securities, and 10% other investments.

Financial assets carried at fair value included in the Plan are classified in the tables below in one of the three categories described above:

	<u>2015</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 2,221,137	\$ -	\$ -	\$ 2,221,137
Fixed income:				
Government bonds	-	6,808,588	-	6,808,588
Corporate bonds	-	4,019,003	-	4,019,003
Equities:				
International	10,151,161	-	-	10,151,161
Mid cap	2,611,160	-	-	2,611,160
Large cap	19,382,959	-	-	19,382,959
Alternative investments	-	-	9,489,940	9,489,940
	<u>\$ 34,366,417</u>	<u>\$ 10,827,591</u>	<u>\$ 9,489,940</u>	<u>\$ 54,683,948</u>

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2015 and 2014

	2014			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 1,698,509	\$ -	\$ -	\$ 1,698,509
Fixed income:				
Government bonds	-	6,703,907	-	6,703,907
Corporate bonds	-	4,163,447	-	4,163,447
Equities:				
International	13,234,227	-	-	13,234,227
Mid cap	3,003,899	-	-	3,003,899
Large cap	24,138,263	-	-	24,138,263
Alternative investments	-	-	11,473,515	11,473,515
	<u>\$ 42,074,898</u>	<u>\$ 10,867,354</u>	<u>\$ 11,473,515</u>	<u>\$ 64,415,767</u>

The changes in investments classified as Level 3 are as follows for the years ended September 30:

	2015	2014
Beginning balance for the year	\$ 11,473,515	\$ 3,585,006
Purchases	50,000	7,000,000
Sales	(1,257,039)	(172,000)
Net change in unrealized appreciation	<u>(776,536)</u>	<u>1,060,509</u>
Ending balance for the year	<u>\$ 9,489,940</u>	<u>\$ 11,473,515</u>

Alternative investments invested in the defined benefit cash balance plan are carried at fair value based upon, as a practical expedient, net asset values derived from the application of the equity method of accounting. Debt securities and equity securities with readily determinable values are classified as Level 1 as determined based on independent published sources. Level 2 assets are valued 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. Assets that are valued using significant unobservable inputs, such as extrapolated data, proprietary models, or indicative quotes that cannot be corroborated with market data are classified in Level 3 within the fair value hierarchy.

Level 3 assets are valued based on the Hospital's ownership interest in the net asset value ("NAV") of the fund as discussed above. As the NAV reported by each fund is used as a practical expedient to estimate the fair value of the Hospital's interest therein, its classification as Level 3 is based on the Hospital's ability to redeem its interest at or near the measurement date. The Hospital routinely monitors and assesses methodologies and assumptions used in valuing these interests.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Contributions

The Hospital expects to contribute \$535,464 to the Plan in 2016.

Estimated Future Benefit Payments

Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Fiscal years:	
2016	\$ 3,624,646
2017	3,818,547
2018	4,102,026
2019	4,390,263
2020	4,684,716
2021-2025	25,170,005
2026-2030	<u>26,882,796</u>
Total	<u>\$ 72,672,999</u>

7. Medical Malpractice Insurance

Effective October 1, 2004, the Hospital became insured by the Company through Healthcare Alliance Insurance Company, Ltd. ("HAIC"). HAIC was a multi-provider captive insurance company domiciled in the Cayman Islands. The Company was a one-third owner of the captive with two other local hospitals that each hold one-third ownership. The Hospital's insurance coverage was \$1,500,000 per occurrence, and \$3,000,000 in the aggregate. The Hospital had an excess layer of indemnity coverage of \$25,000,000 per occurrence and \$25,000,000 in the aggregate.

Effective July 1, 2013, the Company sold its equity interest in HAIC and the Hospital became insured by Seaside Indemnity Alliance Company ("SIAC"). SIAC was incorporated on May 10, 2013, under the laws of the Cayman Islands and is a wholly owned subsidiary of the Company. SIAC's activities are the direct insurance of the Hospital's professional and comprehensive general liability risks together with the physician professional liability risks of certain of the Hospital's affiliated physicians.

The Hospital's claims-made insurance coverage through SIAC beginning July 1, 2013, is \$26,500,000 per claim with a policy aggregate of \$28,000,000. SIAC purchases reinsurance coverage which is \$25,000,000 per claim and \$25,000,000 in the aggregate.

In addition, SIAC will assume the Company's risks previously insured by an unrelated insurance company during the period 2004 to 2013 via a loss portfolio transfer (LPT). SIAC's retention, as outlined above, in relation to these prior periods (included within the LPT) will be the same.

Management accrues its best estimate of losses as they occur. Accordingly, management has recorded a liability of approximately \$558,000 and \$690,000 at September 30, 2015 and 2014, respectively, for claims incurred but not reported which is included in accrued pension and other liabilities on the accompanying consolidated balance sheet. This liability has been discounted using a 3% discount rate at September 30, 2015 and 2014.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Malpractice claims have been asserted against the Company by various claimants. These claims are in various stages of processing, and some may ultimately be brought to trial. There are known incidents that have occurred through September 30, 2015, that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. In management's opinion, the outcome of these matters will not have a material effect on the Company's consolidated financial statements.

	<u>2015</u>	<u>2014</u>
Unpaid losses and loss adjustments are as follows:		
Reserve for reported claims	\$ 1,367,033	\$ 985,068
Reserve for adverse claims development	<u>3,338,137</u>	<u>2,974,049</u>
	<u>\$ 4,705,170</u>	<u>\$ 3,959,117</u>

Activity in the provision for unpaid losses and loss adjustment expenses, which is included in self-insured professional claims liabilities on the consolidated balance sheets, is summarized as follows:

Balance at October 1, 2014	\$ 3,959,117
Less: reinsurance recoverable	<u>(672,639)</u>
Net balance at September 30, 2014	<u>3,286,478</u>
Losses incurred related to:	
Current year	1,509,483
Prior years	<u>(255,290)</u>
Total incurred	<u>1,254,193</u>
Paid losses related to:	
Current year	(17,945)
Prior years	<u>(302,033)</u>
Total paid	<u>(319,978)</u>
Reinsurance recoverable on loss reserves	<u>484,477</u>
Balance at September 30, 2015	<u>\$ 4,705,170</u>

The change in the provision of incurred losses relating to prior years resulted from recent trends in the Company's loss experience and is not attributable to any one incident.

In the opinion of management, the reserve for losses and loss adjustment expenses as of the balance sheet date, which represents management's best estimate, on a discounted basis, of the Company's liability under the policies issued, is adequate to cover the discounted expected ultimate liability of the risks incurred. Due to the nature of the underlying insurance risks and the general uncertainty surrounding medical malpractice claims settlement, the liability for losses is an estimate and could vary significantly from the amount ultimately paid.

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2015 and 2014

The provision for unpaid losses and loss adjustment is based upon the discounted ultimate liability of the Company as determined by independent actuaries and has been discounted to present value using pay-out patterns derived from insurance industry medical professional liability data using a discount rate of 3%. At September 30, 2015, gross undiscounted total loss provisions were \$2,079,764.

8. Commitments and Contingencies

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management is not aware of any material incidents of noncompliance that have not been provided for in the accompanying financial statements; however, the possible future financial effects of this matter on the Company, if any, are not presently determinable.

9. Functional Expenses

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

	<u>2015</u>	<u>2014</u>
Health care services	\$ 68,001,000	\$ 68,936,000
General and administrative	9,415,000	12,648,000
	<u>\$ 77,416,000</u>	<u>\$ 81,584,000</u>

10. Other Operating Revenues

Other operating revenues consist of the following for the years ended September 30:

	<u>2015</u>	<u>2014</u>
Electronic health records incentive payments	\$ 307,348	\$ 852,995
Rental	1,076,196	1,112,561
Cafeteria	199,149	187,170
Pharmacy	129,226	183,449
Other	70,970	102,228
	<u>\$ 1,782,889</u>	<u>\$ 2,438,403</u>

Milford Health & Medical, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2015 and 2014

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act. The provisions were designed to increase the use of electronic health record ("EHR") technology and establish the requirements for a Medicare and Medicaid incentive payment program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology.

In subsequent years, providers must demonstrate meaningful use of such technology to qualify for additional Medicaid incentive payments. Hospitals that do not successfully demonstrate meaningful use of EHR technology are subject to payment penalties or downward adjustments to their Medicare payments beginning in federal fiscal year 2015.

The Company uses a grant accounting model to recognize revenue for the Medicare and Medicaid EHR incentive payments. Under this accounting policy, EHR incentive payment revenue is recognized when the Company is reasonably assured that the EHR meaningful use criteria for the required period of time were met and that the grant revenue will be received. EHR incentive payment revenue from Medicare and Medicaid for the years ended September 30, 2015 and 2014, was \$307,348 and \$852,995, respectively, and is included in other operating revenues. Income from incentive payments is subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated. Included in due to third-party reimbursement agencies is a retrospective reserve of \$(5,168) and \$218,706 for this purpose as of September 30, 2015 and 2014, respectively. Additionally, the Company's attestation of compliance with the meaningful use criteria is subject to audit.

Milford Health & Medical, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

September 30, 2015

(See Independent Auditors' Report on Supplementary Information)

	Milford Hospital, Inc.	Milford Hospital Foundation, Inc.	Milford Medical Lab, Inc.	Home Care Plus, Inc.	Milford Health & Medical, Inc.	Torry Corporation	Milford Health Care Services, Inc.	Seabridge, Inc.	Seaside Indemnity Alliance, LTD	Consolidation	
										Eliminations	Consolidated
Assets											
Current Assets											
Cash and cash equivalents	\$ 1,171,348	\$ 218,009	\$ 62,198	\$ 71,894	\$ 17,215	\$ 8,816	\$ 433	\$ 359	\$ 423,988	\$ -	\$ 1,974,260
Short-term investments	3,536,565	1,646	-	-	-	-	-	-	-	-	3,538,211
Patient accounts receivable, net of estimated allowance for doubtful accounts of approximately \$3,204,000	8,480,597	-	174,749	915,830	-	-	-	-	-	-	9,571,176
Inventories	775,631	-	-	-	-	-	-	-	-	-	775,631
Prepaid expenses and other current assets	774,760	-	1,621	22,136	2,000	250,659	-	-	223,208	(196,821)	1,077,563
Insured claims receivable	568,833	-	-	-	-	-	-	-	-	(568,833)	-
Total current assets	15,307,734	219,655	238,568	1,009,860	19,215	259,475	433	359	647,196	(765,654)	16,936,841
Investments	457,556	559,605	-	-	-	-	-	-	2,074,913	-	3,092,074
Assets Whose Use is Limited	1,665,769	152,133	-	-	-	-	-	-	4,273,090	-	6,090,992
Property, Plant, and Equipment											
Land and improvements	1,437,941	-	-	-	-	5,214,259	-	-	-	-	6,652,200
Building and improvements	15,581,482	-	50,186	13,384	-	8,147,160	-	-	-	-	23,792,212
Equipment	36,060,889	15,470	96,775	322,617	-	52,264	-	-	-	-	36,548,015
Construction in progress	-	-	-	-	-	183,601	-	-	-	-	183,601
	53,080,312	15,470	146,961	336,001	-	13,597,284	-	-	-	-	67,176,028
Less: accumulated depreciation	(32,778,530)	(5,117)	(140,624)	(276,909)	-	(1,011,397)	-	-	-	-	(34,212,577)
	20,301,782	10,353	6,337	59,092	-	12,585,887	-	-	-	-	32,963,451
Beneficial Interest in Milford Hospital Foundation, Inc.	946,440	-	-	-	-	-	-	-	-	(946,440)	-
Due from Affiliates	1,349,267	6,236	-	-	1,342,992	224,646	-	-	-	(2,923,141)	-
Investment in Affiliates	-	-	-	-	11,506,623	-	-	577,739	-	(11,507,623)	576,739
Insured Claims Receivable, Net	2,477,595	-	-	-	-	-	-	-	484,477	(938,847)	2,023,225
Total assets	<u>\$ 42,506,143</u>	<u>\$ 947,982</u>	<u>\$ 244,905</u>	<u>\$ 1,068,952</u>	<u>\$ 12,868,830</u>	<u>\$ 13,070,008</u>	<u>\$ 433</u>	<u>\$ 578,098</u>	<u>\$ 7,479,676</u>	<u>\$ (17,081,705)</u>	<u>\$ 61,683,322</u>

Milford Health & Medical, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

September 30, 2015

(See Independent Auditors' Report on Supplementary Information)

	<u>Milford Hospital, Inc.</u>	<u>Milford Hospital Foundation, Inc.</u>	<u>Milford Medical Lab, Inc.</u>	<u>Home Care Plus, Inc.</u>	<u>Milford Health & Medical, Inc.</u>	<u>Torry Corporation</u>	<u>Milford Health Care Services, Inc.</u>	<u>Seabridge, Inc.</u>	<u>Seaside Indemnity Alliance, LTD</u>	<u>Consolidation Eliminations</u>	<u>Consolidated</u>
Liabilities and Net Assets (Deficit)											
Current Liabilities											
Current maturities of long-term debt	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 150,501	\$ -	\$ -	\$ -	\$ -	\$ 150,501
Accounts payable	6,717,519	-	34,516	4,644	-	39,434	-	-	44,120	-	6,840,233
Accrued salaries, wages and vacation	5,785,222	-	-	210,966	-	-	-	-	-	-	5,996,188
Estimated third-party payor settlements	920,996	-	-	180,631	-	-	-	-	-	-	1,101,627
Due to affiliates	230,880	1,542	10,814,723	36,115	1,229,436	110,048	770,667	7,800	333,417	(13,534,628)	-
Insured claims liabilities	568,833	-	-	-	-	-	-	-	-	(568,833)	-
Other current liabilities	1,896,404	-	23,403	55,316	-	54,437	-	-	-	-	2,029,560
Total current liabilities	16,119,854	1,542	10,872,642	487,672	1,229,436	354,420	770,667	7,800	377,537	(14,103,461)	16,118,109
Long-Term Debt	8,000,000	-	-	-	-	6,342,431	-	-	-	-	14,342,431
Insured Claims Liabilities, Net	2,477,595	-	-	-	-	-	-	-	-	(938,847)	1,538,748
Self Insured Professional Claims Liabilities	-	-	-	-	-	-	-	-	4,705,170	-	4,705,170
Accrued Pension and Other Liabilities	37,275,828	-	-	-	215,781	-	-	-	926,751	(196,821)	38,221,539
Total liabilities	63,873,277	1,542	10,872,642	487,672	1,445,217	6,696,851	770,667	7,800	6,009,458	(15,239,129)	74,925,997
Net Assets (Deficit)											
Unrestricted	(22,867,574)	(13,799)	(10,628,737)	581,280	11,423,613	6,372,157	(770,234)	565,298	1,370,218	(789,137)	(14,756,915)
Temporarily restricted	826,677	840,476	-	-	-	-	-	-	-	(826,676)	840,477
Permanently restricted	673,763	119,763	-	-	-	-	-	-	-	(119,763)	673,763
Common stock	-	-	1,000	-	-	1,000	-	5,000	100,000	(107,000)	-
Total net assets (deficit)	(21,367,134)	946,440	(10,627,737)	581,280	11,423,613	6,373,157	(770,234)	570,298	1,470,218	(1,842,576)	(13,242,675)
Total liabilities and net assets (deficit)	\$ 42,506,143	\$ 947,982	\$ 244,905	\$ 1,068,952	\$ 12,868,830	\$ 13,070,008	\$ 433	\$ 578,098	\$ 7,479,676	\$ (17,081,705)	\$ 61,683,322

Milford Health & Medical, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

September 30, 2014

(See Independent Auditors' Report on Supplementary Information)

	Milford Hospital, Inc.	Milford Hospital Foundation, Inc.	Milford Medical Lab, Inc.	Home Care Plus, Inc.	Milford Health & Medical, Inc.	Torry Corporation	Milford Health Care Services, Inc.	Seabridge, Inc.	Seaside Indemnity Alliance, LTD	Consolidation	
										Eliminations	Consolidated
Assets											
Current Assets											
Cash and cash equivalents	\$ 6,892,694	\$ 142,155	\$ 64,275	\$ 414,505	\$ 27,464	\$ 13,648	\$ 433	\$ 916	\$ 111,096	\$ -	\$ 7,667,186
Short-term investments	110,778	1,639	-	-	-	-	-	-	-	-	112,417
Patient accounts receivable, net of estimated allowance for doubtful accounts of approximately \$3,344,000	8,850,797	-	213,017	856,040	-	-	-	-	-	-	9,919,854
Inventories	772,809	-	-	-	-	-	-	-	-	-	772,809
Prepaid expenses and other current assets	872,178	6,966	17,121	22,464	2,000	206,199	-	-	1,165,428	(1,133,166)	1,159,190
Insured claims receivable	672,298	-	-	-	-	-	-	-	-	(672,298)	-
Total current assets	18,171,554	150,760	294,413	1,293,009	29,464	219,847	433	916	1,276,524	(1,805,464)	19,631,456
Investments	1,815,473	654,244	-	-	-	-	-	-	2,582,382	-	5,052,099
Assets Whose Use is Limited	1,658,681	160,987	-	-	-	-	-	-	3,349,333	-	5,169,001
Property, Plant, and Equipment											
Land and improvements	1,437,941	-	-	-	-	5,214,259	-	-	-	-	6,652,200
Building and improvements	15,580,795	-	50,186	13,384	-	8,142,915	-	-	-	-	23,787,280
Equipment	34,694,933	15,471	96,775	298,904	-	46,500	-	-	-	-	35,152,583
Construction in progress	-	-	-	-	-	216,038	-	-	-	-	216,038
	51,713,669	15,471	146,961	312,288	-	13,619,712	-	-	-	-	65,808,101
Less: accumulated depreciation	(30,714,786)	(4,329)	(136,903)	(243,555)	-	(745,201)	-	-	-	-	(31,844,774)
	20,998,883	11,142	10,058	68,733	-	12,874,511	-	-	-	-	33,963,327
Beneficial Interest in Milford Hospital Foundation, Inc.	960,239	-	-	-	-	-	-	-	-	(960,239)	-
Due from Affiliates	541,820	4,203	-	-	1,456,150	118,546	-	-	-	(2,120,719)	-
Investment in Affiliates	-	-	-	-	11,506,623	-	-	305,442	-	(11,507,665)	304,400
Insured Claims Receivable, Net	2,795,413	-	-	-	-	-	-	-	672,639	(1,411,641)	2,056,411
Total assets	\$ 46,942,063	\$ 981,336	\$ 304,471	\$ 1,361,742	\$ 12,992,237	\$ 13,212,904	\$ 433	\$ 306,358	\$ 7,880,878	\$ (17,805,728)	\$ 66,176,694

Milford Health & Medical, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

September 30, 2014

(See Independent Auditors' Report on Supplementary Information)

	<u>Milford Hospital, Inc.</u>	<u>Milford Hospital Foundation,</u>	<u>Milford Medical Lab, Inc.</u>	<u>Home Care Plus, Inc.</u>	<u>Milford Health & Medical, Inc.</u>	<u>Torry Corporation</u>	<u>Milford Health Care Services, Inc.</u>	<u>Seabridge, Inc.</u>	<u>Seaside Indemnity Alliance, LTD</u>	<u>Consolidation Eliminations</u>	<u>Consolidated</u>
Liabilities and Net Assets (Deficit)											
Current Liabilities											
Current maturities of long-term debt	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 142,366	\$ -	\$ -	\$ -	\$ -	\$ 142,366
Accounts payable	7,032,887	-	18,474	45,833	-	104,106	-	-	54,578	-	7,255,878
Accrued salaries, wages and vacation	6,690,575	-	-	298,474	-	-	-	-	-	-	6,989,049
Estimated third-party payor settlements	1,386,145	-	-	189,220	-	-	-	-	-	-	1,575,365
Due to affiliates	122,749	21,097	10,381,903	45,630	752,223	86,728	759,408	65,344	8,277	(12,243,359)	-
Insured claims liabilities	672,298	-	-	-	-	-	-	-	-	(672,298)	-
Other current liabilities	1,881,969	-	23,403	-	-	58,642	-	-	-	-	1,964,014
Total current liabilities	17,786,623	21,097	10,423,780	579,157	752,223	391,842	759,408	65,344	62,855	(12,915,657)	17,926,672
Long-Term Debt	6,000,000	-	-	-	-	6,492,523	-	-	-	-	12,492,523
Insured Claims Liabilities, Net	2,795,413	-	-	-	-	-	-	-	-	(1,411,641)	1,383,772
Self Insured Professional Claims Liabilities	-	-	-	-	-	-	-	-	3,959,117	-	3,959,117
Accrued Pension and Other Liabilities	21,382,236	-	-	-	1,133,166	-	-	-	2,388,688	(1,133,166)	23,770,924
Total liabilities	47,964,272	21,097	10,423,780	579,157	1,885,389	6,884,365	759,408	65,344	6,410,660	(15,460,464)	59,533,008
Net Assets (Deficit)											
Unrestricted	(2,536,448)	-	(10,120,309)	782,585	11,106,848	6,327,539	(758,975)	236,014	1,370,218	(1,278,026)	5,129,446
Temporarily restricted	840,476	840,476	-	-	-	-	-	-	-	(840,475)	840,477
Permanently restricted	673,763	119,763	-	-	-	-	-	-	-	(119,763)	673,763
Common stock	-	-	1,000	-	-	1,000	-	5,000	100,000	(107,000)	-
Total net assets (deficit)	(1,022,209)	960,239	(10,119,309)	782,585	11,106,848	6,328,539	(758,975)	241,014	1,470,218	(2,345,264)	6,643,686
Total liabilities and net assets (deficit)	\$ 46,942,063	\$ 981,336	\$ 304,471	\$ 1,361,742	\$ 12,992,237	\$ 13,212,904	\$ 433	\$ 306,358	\$ 7,880,878	\$ (17,805,728)	\$ 66,176,694

Milford Health & Medical, Inc. and Subsidiaries

Schedule of Consolidating Information, Statement of Operations

Year Ended September 30, 2015

(See Independent Auditors' Report on Supplementary Information)

	Milford Hospital, Inc.	Milford Hospital Foundation, Inc.	Milford Medical Lab, Inc.	Home Care Plus, Inc.	Milford Health & Medical, Inc.	Torry Corporation	Milford Health Care Services, Inc.	Seabridge, Inc.	Seaside Indemnity Alliance, LTD	Consolidation	
										Eliminations	Consolidated
Operating Revenues											
Patient services revenues	\$ 63,929,340	\$ -	\$ 905,385	\$ 3,963,275	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 68,798,000
Provision for bad debts	(3,556,700)	-	(30,671)	(310,920)	-	-	-	-	-	-	(3,898,291)
Net patient service revenues (less provision for bad debts)	60,372,640	-	874,714	3,652,355	-	-	-	-	-	-	64,899,709
Inpatient Rehabilitation Unit income, net	2,898,446	-	-	-	-	-	-	-	-	-	2,898,446
Other revenues	669,361	-	45,405	3,723	-	1,214,763	-	-	1,895,455	(2,079,426)	1,749,281
Total operating revenues	63,940,447	-	920,119	3,656,078	-	1,214,763	-	-	1,895,455	(2,079,426)	69,547,436
Operating Expenses											
Salaries and wages	32,255,430	26,979	554,446	2,286,501	55,820	80,643	2,306	17,218	-	33,608	35,312,951
Employee benefits	10,121,904	8,973	183,934	486,824	32,705	45,298	722	10,247	-	-	10,890,607
Supplies and other	23,741,342	68,813	774,727	1,119,580	53,359	520,644	2,152	28,781	1,794,258	(2,534,707)	25,568,949
Provision for non-patient bad debts	-	-	-	-	2,374,474	-	-	-	-	-	2,374,474
Depreciation and amortization	2,462,228	788	3,721	33,352	-	266,196	-	-	-	-	2,766,285
Interest	85,184	-	-	-	209	417,157	11,259	-	-	(11,259)	502,550
Total operating expenses	68,666,088	105,553	1,516,828	3,926,257	2,516,567	1,329,938	16,439	56,246	1,794,258	(2,512,358)	77,415,816
Operating income (loss)	(4,725,641)	(105,553)	(596,709)	(270,179)	(2,516,567)	(115,175)	(16,439)	(56,246)	101,197	432,932	(7,868,380)
Nonoperating Income, Net											
Investment income	319,767	60,264	3	510	575,199	-	-	522,304	98,867	55,957	1,632,871
Contributions	-	150,308	-	-	-	-	-	-	-	-	150,308
Net nonoperating income	319,767	210,572	3	510	575,199	-	-	522,304	98,867	55,957	1,783,179
Change in Unrealized Gains and Losses on Investments	(207,863)	(163,429)	-	-	-	-	-	-	(200,064)	-	(571,356)
Revenues in excess of (less than) expenses	\$ (4,613,737)	\$ (58,410)	\$ (596,706)	\$ (269,669)	\$ (1,941,368)	\$ (115,175)	\$ (16,439)	\$ 466,058	\$ -	\$ 488,889	\$ (6,656,557)

Milford Health & Medical, Inc. and Subsidiaries

Schedule of Consolidating Information, Statement of Operations

Year Ended September 30, 2014

(See Independent Auditors' Report on Supplementary Information)

	Milford Hospital, Inc.	Milford Hospital Foundation, Inc.	Milford Medical Lab, Inc.	Home Care Plus, Inc.	Milford Health & Medical, Inc.	Torry Corporation	Milford Health Care Services, Inc.	Seabridge, Inc.	Seaside Indemnity Alliance, LTD	Consolidation	
										Eliminations	Consolidated
Operating Revenues											
Patient services revenues	\$ 69,109,103	\$ -	\$ 1,098,459	\$ 3,603,165	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 73,810,727
Provision for bad debts	(5,608,309)	-	(104,526)	(72,506)	-	-	-	-	-	-	(5,785,341)
Net patient service revenues											
(less provision for bad debts)	63,500,794	-	993,933	3,530,659	-	-	-	-	-	-	68,025,386
Other revenues	1,352,459	-	43,979	5,183	-	1,217,577	-	-	1,271,433	(1,452,228)	2,438,403
Total operating revenues	64,853,253	-	1,037,912	3,535,842	-	1,217,577	-	-	1,271,433	(1,452,228)	70,463,789
Operating Expenses											
Salaries and wages	35,687,359	29,726	669,833	2,145,419	45,077	70,600	1,206	15,168	67,715	-	38,732,103
Employee benefits	9,339,375	9,970	217,418	476,919	13,151	20,304	386	4,643	21,669	-	10,103,835
Supplies and other	24,335,355	66,718	903,626	934,545	80,450	519,622	2,063	28,338	1,535,511	(1,980,584)	26,425,644
Provision for non-patient bad debts	-	-	-	-	2,880,503	-	-	-	-	-	2,880,503
Depreciation and amortization	2,687,549	787	4,643	29,565	-	266,699	-	-	-	-	2,989,243
Interest	26,961	-	-	-	5,117	425,306	11,259	-	-	(16,376)	452,267
Total operating expenses	72,076,599	107,201	1,795,520	3,586,448	3,024,298	1,302,531	14,914	48,149	1,624,895	(1,996,960)	81,583,595
Operating income (loss)	(7,223,346)	(107,201)	(757,608)	(50,606)	(3,024,298)	(84,954)	(14,914)	(48,149)	(353,462)	544,732	(11,119,806)
Nonoperating Income, Net											
Investment income	362,189	41,212	3	1,619	530,007	-	-	260,258	433,083	84,411	1,712,782
Contributions	-	156,498	-	-	-	-	-	-	-	-	156,498
Net nonoperating income	362,189	197,710	3	1,619	530,007	-	-	260,258	433,083	84,411	1,869,280
Change in Unrealized Gains and Losses on Investments	(342,578)	49,898	-	-	-	-	-	-	(79,621)	(49,898)	(422,199)
Revenues in excess of (less than) expenses	\$ (7,203,735)	\$ 140,407	\$ (757,605)	\$ (48,987)	\$ (2,494,291)	\$ (84,954)	\$ (14,914)	\$ 212,109	\$ -	\$ 579,245	\$ (9,672,725)