

Danbury Hospital
14-024AR
Report 1

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

The Danbury Hospital and Subsidiary
Years Ended September 30, 2014 and 2013
With Report of Independent Auditors

Ernst & Young LLP



EY

Building a better
working world

The Danbury Hospital and Subsidiary

Consolidated Financial Statements
and Supplementary Information

Years Ended September 30, 2014 and 2013

Contents

| | |
|---|----|
| Report of Independent Auditors..... | 1 |
| Consolidated Financial Statements | |
| Consolidated Balance Sheets | 3 |
| Consolidated Statements of Operations and Changes in Net Assets | 5 |
| Consolidated Statements of Cash Flows..... | 7 |
| Notes to Consolidated Financial Statements..... | 8 |
| Supplementary Information | |
| Years Ended September 30, 2014 and 2013 | |
| Consolidating Balance Sheets..... | 32 |
| Consolidating Statements of Operations..... | 34 |



Building a better
working world

Ernst & Young LLP
20 Church Street
Hartford, CT 06103

Tel: +1 860 247 3100
Fax: +1 860 725 6040
ey.com

Report of Independent Auditors

The Board of Directors
The Danbury Hospital

We have audited the accompanying consolidated financial statements of The Danbury Hospital and Subsidiary, which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We 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 13% and 8% as of September 30, 2014 and 2013, respectively, and total revenues constituting 4% in 2014 and 3% in 2013, respectively, 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



Building a better
working world

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, 2014 and 2013, 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 sheets and statements 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 financial statements as a whole.

Ernst + Young LLP

February 27, 2015

The Danbury Hospital and Subsidiary

Consolidated Balance Sheets

| | September 30 | |
|---|-----------------------|-----------------------|
| | 2014 | 2013 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 49,109,529 | \$ 59,531,409 |
| Current portion of assets limited as to use | 9,863,637 | 4,989,827 |
| Accounts receivable, less allowance for uncollectible accounts of approximately \$13,480,000 in 2014 and \$14,833,000 in 2013 | 63,595,267 | 57,504,970 |
| Current portion of due from related parties | 7,417,177 | 7,022,757 |
| Inventories | 10,027,585 | 9,521,995 |
| Prepaid expenses and other | 23,639,322 | 13,488,041 |
| Total current assets | <u>163,652,517</u> | <u>152,058,999</u> |
| Assets limited as to use: | | |
| Construction funds | — | 45,694,876 |
| Investments held by WCHNIC | 97,159,849 | 58,410,610 |
| Total noncurrent assets limited as to use | <u>97,159,849</u> | <u>104,105,486</u> |
| Investments | 204,451,643 | 199,169,615 |
| Other assets | 782,530 | 195,559 |
| Due from related parties | 904,678 | 5,739,847 |
| Interest in Western Connecticut Health Network Foundation, Inc. | 97,632,022 | 106,193,031 |
| Property, plant, and equipment: | | |
| Land and land improvements | 10,667,284 | 9,964,052 |
| Buildings and building improvements | 428,286,085 | 293,253,282 |
| Equipment and other | 251,398,149 | 222,804,495 |
| Construction-in-progress (estimated cost to complete at September 30, 2014: \$12,424,000) | 17,786,049 | 105,866,676 |
| | <u>708,137,567</u> | <u>631,888,505</u> |
| Less accumulated depreciation | 356,467,852 | 328,300,919 |
| | <u>351,669,715</u> | <u>303,587,586</u> |
| Bond issuance costs, net | 4,611,155 | 5,099,525 |
| Total assets | <u>\$ 920,864,109</u> | <u>\$ 876,149,648</u> |

| | September 30 | |
|--------------------------------------|--------------------|--------------------|
| | 2014 | 2013 |
| Liabilities and net assets | | |
| Current liabilities: | | |
| Accounts payable | \$ 33,109,728 | \$ 33,744,172 |
| Payroll-related accruals | 31,635,886 | 28,385,032 |
| Due to third-party payors | 14,656,782 | 8,710,030 |
| Interest payable | 1,791,204 | 1,706,774 |
| Other accrued expenses | 3,214,245 | 2,933,157 |
| Current portion of long-term debt | 4,925,000 | 2,880,000 |
| Total current liabilities | <u>89,332,845</u> | <u>78,359,165</u> |
| Self-insurance liabilities | 82,107,023 | 46,380,935 |
| Other long-term liabilities | 18,355,703 | 18,062,437 |
| Long-term debt, less current portion | 241,775,000 | 246,700,000 |
| Total liabilities | <u>431,570,571</u> | <u>389,502,537</u> |
| Net assets: | | |
| Unrestricted | 412,096,873 | 400,930,008 |
| Temporarily restricted | 47,726,160 | 56,603,735 |
| Permanently restricted | 29,470,505 | 29,113,368 |
| Total net assets | <u>489,293,538</u> | <u>486,647,111</u> |

Total liabilities and net assets

\$ 920,864,109 \$ 876,149,648

See accompanying notes.

The Danbury Hospital and Subsidiary

Consolidated Statements of Operations and Changes in Net Assets

| | Year Ended September 30 | |
|---|--------------------------------|--------------------|
| | 2014 | 2013 |
| Unrestricted revenues: | | |
| Net patient service revenue | \$ 521,477,663 | \$ 518,977,309 |
| Provision for uncollectible accounts | 16,984,907 | 19,104,169 |
| Net patient service revenue, less provision for uncollectible accounts | 504,492,756 | 499,873,140 |
| Net assets released from restrictions | 5,665,862 | 5,221,901 |
| Other operating revenues | 25,623,700 | 18,807,540 |
| | <u>535,782,318</u> | <u>523,902,581</u> |
| Expenses: | | |
| Salaries, benefits, and fees | 300,891,797 | 298,251,765 |
| Supplies and other | 156,187,262 | 147,192,020 |
| Insurance | 21,591,676 | 15,709,626 |
| Depreciation and amortization | 31,682,167 | 30,033,213 |
| Interest | 4,557,028 | 3,984,131 |
| | <u>514,909,930</u> | <u>495,170,755</u> |
| Income from operations | 20,872,388 | 28,731,826 |
| Nonoperating income (loss): | | |
| Investment income, net | 3,546,237 | 4,504,328 |
| Change in unrealized gains and losses on investments | 11,254,037 | 5,199,125 |
| Change in equity interest in unrestricted net assets of the Western Connecticut Health Network Foundation, Inc. | (40,571) | 206,244 |
| | <u>14,759,703</u> | <u>9,909,697</u> |
| Excess of revenues over expenses | <u>35,632,091</u> | <u>38,641,523</u> |

Continued on next page.

The Danbury Hospital and Subsidiary

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

| | Year Ended September 30 | |
|--|-------------------------|----------------|
| | 2014 | 2013 |
| Unrestricted net assets: | | |
| Excess of revenues over expenses (continued) | \$ 35,632,091 | \$ 38,641,523 |
| Change in equity interest of the Western Connecticut Health Network Foundation, Inc. | - | (17,618) |
| Net assets released from restrictions for property, plant, and equipment | 14,916,145 | 4,908,000 |
| Transfer from Maple Street Indemnity Company, Ltd. | 15,453,580 | - |
| Transfers to Western Connecticut Health Network, Inc. | (54,834,951) | (28,604,162) |
| Increase in unrestricted net assets | 11,166,865 | 14,927,743 |
| Temporarily restricted net assets: | | |
| Change in equity interest of the Western Connecticut Health Network Foundation, Inc. | (8,877,575) | 26,809,647 |
| Transfers from Western Connecticut Health Network Foundation, Inc. | 20,582,007 | 10,129,901 |
| Net assets released from restrictions | (5,665,862) | (5,221,901) |
| Net assets released from restrictions for property, plant, and equipment | (14,916,145) | (4,908,000) |
| (Decrease) increase in temporarily restricted net assets | (8,877,575) | 26,809,647 |
| Permanently restricted net assets: | | |
| Change in equity interest of the Western Connecticut Health Network Foundation, Inc. | 357,137 | 288,622 |
| Increase in permanently restricted net assets | 357,137 | 288,622 |
| Increase in net assets | 2,646,427 | 42,026,012 |
| Net assets at beginning of year | 486,647,111 | 444,621,099 |
| Net assets at end of year | \$ 489,293,538 | \$ 486,647,111 |

See accompanying notes.

The Danbury Hospital and Subsidiary
Consolidated Statements of Cash Flows

| | Year Ended September 30 | |
|---|-------------------------|---------------|
| | 2014 | 2013 |
| Operating activities | | |
| Increase in net assets | \$ 2,646,427 | \$ 42,026,012 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 31,682,167 | 30,033,213 |
| Change in unrealized gains and losses on investments | (11,254,037) | (5,199,125) |
| Decrease (increase) in equity interest in net assets of the Western Connecticut Health Network Foundation, Inc. | 8,561,009 | (27,286,895) |
| Transfers from the Western Connecticut Health Network Foundation, Inc. | (20,582,007) | (10,129,901) |
| Transfer from Maple Street Indemnity Company, Ltd. | (15,453,580) | - |
| Transfers to Western Connecticut Health Network, Inc. | 54,834,951 | 28,604,162 |
| Provision for uncollectible accounts | 16,984,907 | 19,104,169 |
| Increase in other long-term liabilities | 293,266 | 652,217 |
| Increase in self-insurance liabilities | 4,295,930 | 4,063,268 |
| Changes in operating assets and liabilities (see Note 11) | (25,319,649) | (1,354,605) |
| Net cash provided by operating activities | 46,689,384 | 80,512,515 |
| Investing activities | | |
| Additions to property, plant, and equipment, net | (79,275,926) | (91,048,296) |
| Increase in due from related parties and transfers to Western Connecticut Health Network, Inc. and affiliates | (50,394,202) | (24,463,516) |
| Drawdown of construction funds | 45,694,876 | 54,857,441 |
| Purchases and sales in investments, net | 9,161,981 | (23,361,751) |
| Net cash used in investing activities | (74,813,271) | (84,016,122) |
| Financing activities | | |
| Payments of long-term debt | (2,880,000) | (1,555,000) |
| Transfers from the Western Connecticut Health Network Foundation, Inc. | 20,582,007 | 10,129,901 |
| Net cash provided by financing activities | 17,702,007 | 8,574,901 |
| Net (decrease) increase in cash and cash equivalents | (10,421,880) | 5,071,294 |
| Cash and cash equivalents at beginning of year | 59,531,409 | 54,460,115 |
| Cash and cash equivalents at end of year | \$ 49,109,529 | \$ 59,531,409 |

See accompanying notes.

The Danbury Hospital and Subsidiary
Notes to Consolidated Financial Statements

September 30, 2014

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 the Hospital is appointed by the Network.

The accompanying consolidated financial statements include the accounts of the Hospital and the Hospital's wholly owned subsidiary, Western Connecticut Health Network Insurance Co., Ltd. (WCHNIC). All material intercompany transactions have been eliminated. 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 \$1,799,988; \$45,013,033 in investments; \$31,430,158 in unpaid claims liabilities; and other assets and liabilities, net of \$70,717, to WCHNIC.

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 financial statements and related footnotes. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

Regulatory Matters

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

Cash and Cash Equivalents

Cash and cash equivalents 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. Cash and cash equivalents are maintained with domestic financial institutions with deposits that exceed federally insured limits. It is the Hospital's policy to monitor the financial strength of these institutions.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Investments

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

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, on the consolidated balance sheets. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the excess of revenues over expenses unless the income is restricted by donor or by law.

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.

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 contributions restricted for certain health care services. Permanently restricted net assets, which are primarily endowment gifts and assets held in trusts by others, have been restricted by donors and are to be maintained in perpetuity.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use represent assets set aside by the Board of Directors for the purpose of providing for future improvement, expansion, and replacement of plant and equipment; assets held by trustees under indenture agreements related to financing activities with the State of Connecticut Health and Educational Facilities Authority (CHEFA); and investments held by WCHNIC. 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 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 Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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.

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 35% and 14%, and 32% and 13%, for Medicare and Medicaid, respectively, at September 30, 2014 and 2013, respectively.

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 42 years.

Conditional asset retirement obligations amounted to \$179,212 and \$377,224 as of September 30, 2014 and 2013, respectively. These obligations are recorded in other long-term liabilities in the accompanying consolidated balance sheets. There are no assets that are legally restricted for purposes of settling asset retirement obligations. During 2014 and 2013, retirement obligations incurred and settled were minimal.

Bond Issuance Costs

Premium discounts and deferred costs related to the issuance of bonds are amortized over the period the obligation is outstanding, using the bonds outstanding method. Accumulated amortization of discounts and deferred costs was \$1,322,065 and \$1,019,449 at September 30, 2014 and 2013, respectively.

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)

1. Summary of Significant Accounting Policies (continued)

Excess of Revenues Over Expenses

The consolidated statements of operations and changes in net assets include the excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from the 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 equity interest of the Western Connecticut Health Network Foundation, Inc. (WCHNF). The permanent transfer of assets includes transfers to the Network of \$54,834,951 and the transfer of net assets from MSIC of \$15,453,580, due to the merger of WCHNIC and MSIC, as previously described.

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

Fair Value of Financial Instruments

The carrying value of financial instruments classified as current assets and current liabilities as of September 30, 2014 and 2013, 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.

Pension Plan

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 \$6,655,153 and \$2,550,276 for 2014 and 2013, 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 \$11,474,680 and \$9,825,094 for fiscal years 2014 and 2013, respectively.

The Network's defined benefit pension plan had estimated projected benefit obligations of \$556,602,668 and \$470,766,653 at September 30, 2014 and 2013, respectively, and the fair value of plan assets was \$482,883,555 and \$432,861,058 at September 30, 2014 and 2013, respectively. The discount rate used to determine the benefit obligation was 4.62% and 5.25% at September 30, 2014 and 2013, respectively.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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.

At September 30, 2014, the Hospital had net operating loss carryforwards from unrelated business activities of approximately \$44,283,000, which will begin expiring in 2018. A deferred tax asset for these losses of approximately \$17,713,000 is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future periods.

Interest in the Western Connecticut Health Network Foundation, Inc.

The interest in 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).

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 \$752,720 and \$1,832,059 of EHR revenues during its fiscal years ended September 30, 2014 and 2013, respectively, consisting of \$0 and \$271,467 of Medicaid revenues in 2014 and 2013, respectively, and \$752,720 and \$1,560,592 of Medicare revenues in 2014 and 2013, respectively. EHR revenues are included in other operating revenues in the accompanying consolidated statements of operations and changes in net assets.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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.

Other Operating Revenues

Other operating revenues consists primarily of the net premiums and interest income of WCHNIC, support service, services provided to other Network affiliates, grant income, and rental income of the Hospital.

Reclassifications

Certain 2013 amounts have been reclassified to conform to the 2014 presentation. These reclassifications are not material to the overall consolidated financial statements.

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 is required on October 1, 2017, and management is currently evaluating the effect of this guidance on its consolidated financial statements.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

2. Net Patient Service Revenue and Charity Care

The following summarizes net patient service revenue:

| | Year Ended September 30 | |
|--|-------------------------|-----------------------|
| | 2014 | 2013 |
| Gross patient service revenue | \$ 1,291,510,052 | \$ 1,231,890,672 |
| Deductions: | | |
| Allowances | 757,431,134 | 699,965,012 |
| Charity care (at charges) | 12,601,255 | 12,948,351 |
| | <u>770,032,389</u> | <u>712,913,363</u> |
| Net patient service revenue | 521,477,663 | 518,977,309 |
| Provision for uncollectible accounts | 16,984,907 | 19,104,169 |
| Net patient service revenue less provision for uncollectible accounts | <u>\$ 504,492,756</u> | <u>\$ 499,873,140</u> |

During 2014 and 2013, approximately 33% and 6%, and 33% and 7%, respectively, of net patient service revenue was received under the Medicare and Medicaid programs, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Hospital believes it is in compliance with all applicable laws and regulations. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

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

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

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

such audits, reviews, and investigations. During 2014 and 2013, the Hospital recorded an increase (decrease) in net patient service revenue of approximately \$695,000 and (\$890,000), respectively, related to changes in previously estimated third-party payor settlements.

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

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

| | Year Ended September 30 | |
|--------------------|-------------------------|-----------------------|
| | 2014 | 2013 |
| Third-party payors | \$ 502,602,891 | \$ 497,003,016 |
| Self-pay patients | 18,874,772 | 21,974,293 |
| | <u>\$ 521,477,663</u> | <u>\$ 518,977,309</u> |

It is the policy of the Hospital to provide necessary care to all persons seeking treatment without discrimination on the grounds of age, race, creed, national origin, or any other grounds unrelated to an individual's need for the service or the availability of the needed service at the Hospital. A patient is classified as a charity care patient by reference to 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 estimated cost of charity care provided was approximately \$4,731,000 and \$4,954,000 for the years ended September 30, 2014 and 2013, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

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 | |
|--|----------------|----------------|
| | 2014 | 2013 |
| Cash and cash equivalents | \$ 50,922,406 | \$ 8,203,924 |
| Money market funds | 1,868,637 | 46,884,703 |
| Common collective funds | 81,247,283 | 75,185,245 |
| Fixed income securities | 16,122,947 | 52,070,347 |
| Mutual funds | 138,540,545 | 107,967,214 |
| Alternative investments (at equity method) | 22,773,311 | 17,953,495 |
| | \$ 311,475,129 | \$ 308,264,928 |

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

| | 2014 | 2013 |
|--|--------------|--------------|
| Interest and dividend income | \$ 2,713,804 | \$ 2,683,955 |
| Realized gains and losses, net and equity income on alternative investments | 832,433 | 1,820,373 |
| | \$ 3,546,237 | \$ 4,504,328 |

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 Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

4. Fair Values of Financial Instruments (continued)

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.

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, 2014 | | | |
|---|-----------------------|----------------------|-------------|-----------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Cash and cash equivalents | \$ 49,109,529 | \$ - | \$ - | \$ 49,109,529 |
| Investments and assets limited as to use: | | | | |
| Cash and cash equivalents | 50,922,406 | - | - | 50,922,406 |
| Money market funds | 1,868,637 | - | - | 1,868,637 |
| Domestic equity: | | | | |
| Common collective funds | - | 61,417,251 | - | 61,417,251 |
| International equity: | | | | |
| Common collective funds | - | 16,638,603 | - | 16,638,603 |
| Fixed income: | | | | |
| Mutual funds | 138,540,545 | - | - | 138,540,545 |
| Securities | 8,515,250 | 7,607,697 | - | 16,122,947 |
| Other: | | | | |
| Common collective funds | - | 3,191,429 | - | 3,191,429 |
| | <u>\$ 248,956,367</u> | <u>\$ 88,854,980</u> | <u>\$ -</u> | <u>\$ 337,811,347</u> |

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

4. Fair Values of Financial Instruments (continued)

| | September 30, 2013 | | | Total |
|---|-----------------------|----------------------|-------------|-----------------------|
| | Level 1 | Level 2 | Level 3 | |
| Cash and cash equivalents | \$ 59,531,409 | \$ - | \$ - | \$ 59,531,409 |
| Investments and assets limited as to use: | | | | |
| Cash and cash equivalents | 8,203,924 | - | - | 8,203,924 |
| Money market funds | 46,884,703 | - | - | 46,884,703 |
| Domestic equity: | | | | |
| Common collective funds | - | 56,495,340 | - | 56,495,340 |
| International equity: | | | | |
| Common collective funds | - | 15,744,898 | - | 15,744,898 |
| Fixed income: | | | | |
| Mutual funds | 107,967,214 | - | - | 107,967,214 |
| Securities | 39,965,010 | 12,105,337 | - | 52,070,347 |
| Other: | | | | |
| Common collective funds | - | 2,945,007 | - | 2,945,007 |
| | <u>\$ 262,552,260</u> | <u>\$ 87,290,582</u> | <u>\$ -</u> | <u>\$ 349,842,842</u> |

The amounts reported in the tables above do not include alternative investments totaling \$22,773,311 and \$17,953,495 at September 30, 2014 and 2013, respectively, which are accounted for under the equity method of accounting.

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.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt and Credit Facility

Long-term debt consisted of the following:

| | September 30 | |
|--|-----------------------|-----------------------|
| | 2014 | 2013 |
| Hospital revenue bonds financed with CHEFA: Series H | \$ 39,615,000 | \$ 39,615,000 |
| Intercompany debt with Western Connecticut Health Network, Inc. | 207,085,000 | 209,965,000 |
| | <u>246,700,000</u> | <u>249,580,000</u> |
| Less current portion | 4,925,000 | 2,880,000 |
| | <u>\$ 241,775,000</u> | <u>\$ 246,700,000</u> |

The following is a summary of the combined aggregate amount of maturities and sinking fund requirements of the aforementioned obligations at September 30, 2014, according to their long-term amortization schedule:

| | |
|------------|-----------------------|
| 2015 | \$ 4,925,000 |
| 2016 | 5,485,000 |
| 2017 | 5,700,000 |
| 2018 | 5,930,000 |
| 2019 | 6,150,000 |
| Thereafter | 218,510,000 |
| | <u>\$ 246,700,000</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 \$256,598,000 and \$250,296,000 at September 30, 2014 and 2013, respectively. These fair values are categorized as Level 2 in the fair value hierarchy described in Note 4. The Hospital paid interest of \$7,783,800 and \$7,661,698 in 2014 and 2013, respectively. The Hospital has capitalized interest of approximately \$3,311,000 and \$3,760,000 in 2014 and 2013, respectively. Debt service funds held under bond indenture agreements for Series H Bonds and Series N Bonds were \$1,868,637 and \$1,189,827 at September 30, 2014 and 2013, respectively.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

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 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 is 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, 2014 or 2013.

The Network holds four series of bonds. In 2011, the Obligated Group was expanded to include the Network, The New Milford Hospital, Inc. (New Milford Hospital), New Milford Hospital Foundation, Inc., and Western Connecticut Medical Group, P.C. In 2013, New Milford Hospital Foundation, Inc. was dissolved. 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 \$33,035,000. The Series K Bonds bear interest at a bank purchase rate (1.390% and 1.410% at September 30, 2014 and 2013, respectively) and mature serially from September 30, 2011 to September 30, 2036. The Series M 2011 revenue bonds (Series M Bonds) were issued in the aggregate principle of \$46,030,000, 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 \$96,000,000 were issued concurrently with Series M Bonds and are subject to annual sinking fund installments commencing July 1, 2015, and continuing through final maturity on July 1, 2041. The Series L Bonds bear interest at a bank purchase rate (1.298% and 1.319% at September 30, 2014 and

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

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

2013, respectively). The proceeds of the Series L Bonds and Series M Bonds are being 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 \$39,880,000 and bear 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.

6. Commitments and Contingencies

Litigation

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

Workers' Compensation Insurance

The Hospital is self-insured for workers' compensation benefits. Liabilities of \$6,464,000 and \$6,468,000, using a discount rate of 5.6%, have been accrued as of September 30, 2014 and 2013, respectively, based on expected future payments pertaining to such years and are included in other long-term liabilities in the accompanying consolidated balance sheets.

Operating Leases

The Hospital has several operating lease agreements for certain real estate and equipment. Certain of these leases have renewal options for periods up to five years and escalation clauses. Rent is payable in equal monthly installments. Rent expense was \$8,087,581 and \$7,987,900 for the years ended September 30, 2014 and 2013, respectively.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

6. Commitments and Contingencies (continued)

The future minimum lease payments are as follows:

| | |
|------------|----------------------|
| 2015 | \$ 8,140,609 |
| 2016 | 7,324,330 |
| 2017 | 6,936,734 |
| 2018 | 6,262,007 |
| 2019 | 5,378,212 |
| Thereafter | 11,321,789 |
| | <u>\$ 45,363,681</u> |

7. Related Party Transactions

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

| | September 30 | |
|---|---------------------|----------------------|
| | 2014 | 2013 |
| Western Connecticut Health Network Affiliates, Inc. | \$ 401,708 | \$ 240,591 |
| New Milford Hospital | 4,067,261 | 8,136,248 |
| Norwalk Hospital | 558,219 | - |
| Norwalk Hospital Foundation | 17,567 | - |
| Eastern New York Medical Services, P.C. | (177,810) | - |
| Business Systems, Inc. | - | (8,466) |
| WCHNF | 2,987,997 | 660,932 |
| Western Connecticut Home Care, Inc. | 321,905 | 303,991 |
| Western Connecticut Health Network, Inc. | 145,008 | 141,178 |
| Western Connecticut Medical Group, P.C. | - | 3,288,130 |
| | <u>\$ 8,321,855</u> | <u>\$ 12,762,604</u> |

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

7. Related Party Transactions (continued)

The Hospital earned income from related parties as follows:

| | Year Ended September 30 | |
|---|-------------------------|--------------|
| | 2014 | 2013 |
| Western Connecticut Health Network Affiliates, Inc. | \$ 104,356 | \$ 93,470 |
| Western Connecticut Medical Group, P.C. | 2,189,615 | 1,842,891 |
| WCHNF | 81,493 | 77,528 |
| New Milford Hospital | 286,068 | 283,094 |
| | \$ 2,661,532 | \$ 2,296,983 |

Western Connecticut Medical Group, P.C. (WCMG) is a tax-exempt professional corporation which provides medical services to the Hospital. Charges for physician services provided to the Hospital by WCMG were \$54,686,388 and \$52,041,883 for the years ended September 30, 2014 and 2013, respectively. In 2014 and 2013, respectively, the Hospital transferred net assets of \$54,834,951 and \$28,604,162 to the Network primarily relating to funding the Hospital made to the defined benefit pension plan and benefits paid on their behalf as well as to fund WCMG and New Milford Hospital primarily relating to the payment of salaries, benefits, and accounts payable on their behalf.

In 2014 and 2013, respectively, WCHNF transferred net assets of \$20,582,007 and \$10,129,901 to the Hospital relating to restricted funds appropriated for spending.

8. Professional Liability Self-Insurance

Effective October 1, 2004, the Hospital formed a captive insurance company, WCHNIC, domiciled in the Cayman Islands, to provide alternative professional liability insurance to the Hospital and New Milford Hospital, as of October 1, 2010, WCMG and Norwalk Hospital and affiliates, as of March 1, 2014, as well as providing community doctors with a competitive professional liability insurance option. In addition, all claims prior to March 1, 2014, that were previously insured by MSIC were assumed through a loss portfolio transfer by WCHNIC, at which time all risk was assumed.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

8. Professional Liability Self-Insurance (continued)

Coverage for medical malpractice insurance is on a claims-made basis. The coverage limits are \$5,000,000 per claim and \$25,000,000 in the aggregate. The excess indemnity coverage is \$40,000,000 per claim and \$40,000,000 in the aggregate. The Hospital has recorded a liability of \$9,899,000 and \$9,596,000 at September 30, 2014 and 2013, respectively, based on a discount rate of 3.5% for incurred-but-not-reported claims, which is included in other long-term liabilities on the accompanying consolidated balance sheets.

Assets held by WCHNIC approximate \$123,703,000 and \$68,030,000 as of September 30, 2014 and 2013, 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 \$82,267,000 and \$46,411,000 as of September 30, 2014 and 2013, 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, 2014 and 2013, is summarized as follows:

| | <u>2014</u> | <u>2013</u> |
|---|----------------------|----------------------|
| Balance at beginning of year | \$ 46,294,520 | \$ 39,513,628 |
| Incurred related to: | | |
| Current period | 17,017,358 | 9,715,410 |
| Prior period | 1,915,868 | 4,608,067 |
| Total incurred | <u>18,933,226</u> | <u>14,323,477</u> |
| Paid related to: | | |
| Current period | (160,035) | (60,267) |
| Prior period | (14,506,446) | (7,482,318) |
| Total paid | <u>(14,666,481)</u> | <u>(7,542,585)</u> |
| Add: Transfer of unpaid losses from MSIC | 31,430,158 | - |
| Net provision for losses and loss adjustment expenses | <u>\$ 81,991,423</u> | <u>\$ 46,294,520</u> |

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

8. Professional Liability Self-Insurance (continued)

Also included in self-insurance liabilities as of September 30, 2014 and 2013, are unearned premiums of \$115,600 and \$86,415, respectively.

The actuary estimated 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, 2014 and 2013; 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.

9. Net Assets

Temporarily restricted net assets of \$47,726,160 and \$56,603,735 as of September 30, 2014 and 2013, respectively, are available to the Hospital for health care services. Permanently restricted net assets total \$29,470,505 and \$29,113,368 as of September 30, 2014 and 2013, respectively, and are investments to be held in perpetuity, the income from which is expendable to support health care services.

10. Endowments

The WCHNF endowment consists of approximately 32 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.

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

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

10. Endowments (continued)

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 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.

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

10. 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 | \$ — | \$ 13,427,522 | \$ 26,038,971 | \$ 39,466,493 |
| Board-designated endowment funds | 9,785,387 | — | — | 9,785,387 |
| Endowment net assets at end of year | <u>\$ 9,785,387</u> | <u>\$ 13,427,522</u> | <u>\$ 26,038,971</u> | <u>\$ 49,251,880</u> |

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

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|--|---------------------|---------------------------|---------------------------|----------------------|
| Endowment net assets at beginning of the year | \$ 9,114,504 | \$ 15,272,502 | \$ 25,789,214 | \$ 50,176,220 |
| Investment return: | 170,178 | 703,496 | — | 873,674 |
| Investment income, net | | | | |
| Change in unrealized gains and losses | 500,705 | 2,174,932 | — | 2,675,637 |
| Total investment return | 670,883 | 2,878,428 | — | 3,549,311 |
| Contributions | — | 353,083 | 131,085 | 484,168 |
| Appropriation of endowment assets for expenditures | — | (4,957,819) | — | (4,957,819) |
| Other changes: | | | | |
| Transfers to permanently restricted endowment | — | (118,672) | 118,672 | — |
| Endowment net assets at end of year | <u>\$ 9,785,387</u> | <u>\$ 13,427,522</u> | <u>\$ 26,038,971</u> | <u>\$ 49,251,880</u> |

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

10. Endowments (continued)

Endowment net asset composition by type of fund as of September 30, 2013, consisted of the following:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|-------------------------------------|---------------------|-----------------------------------|-----------------------------------|----------------------|
| Donor-restricted endowment funds | \$ — | \$ 15,272,502 | \$ 25,789,214 | \$ 41,061,716 |
| Board-designated endowment funds | 9,114,504 | — | — | 9,114,504 |
| Endowment net assets at end of year | <u>\$ 9,114,504</u> | <u>\$ 15,272,502</u> | <u>\$ 25,789,214</u> | <u>\$ 50,176,220</u> |

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

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|--|---------------------|-----------------------------------|-----------------------------------|----------------------|
| Endowment net assets at beginning of the year | \$ 8,357,137 | \$ 13,820,607 | \$ 25,696,434 | \$ 47,874,178 |
| Investment return: | | | | |
| Investment income, net | 658,488 | 2,955,473 | — | 3,613,961 |
| Change in unrealized gains and losses | 98,879 | 409,998 | — | 508,877 |
| Total investment return | <u>757,367</u> | <u>3,365,471</u> | <u>—</u> | <u>4,122,838</u> |
| Contributions | — | 299,260 | 167,635 | 466,895 |
| Appropriation of endowment assets for expenditures | — | (2,148,914) | (138,777) | (2,287,691) |
| Other changes: | | | | |
| Transfers to permanently restricted endowment | — | (63,922) | 63,922 | — |
| Endowment net assets at end of year | <u>\$ 9,114,504</u> | <u>\$ 15,272,502</u> | <u>\$ 25,789,214</u> | <u>\$ 50,176,220</u> |

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

10. 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 were no deficiencies of this nature which were reported in unrestricted net assets for 2014 or 2013.

Also included within permanently restricted net assets is \$3,431,534 and \$3,324,154 of beneficial interests in trusts held by others as of September 30, 2014 and 2013, respectively.

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

| | Year Ended September 30 | |
|--|-------------------------|-----------------------|
| | 2014 | 2013 |
| (Increase) decrease in operating assets: | | |
| Accounts receivable, net | \$ (23,075,204) | \$ (16,570,204) |
| Inventories | (505,590) | (188,623) |
| Prepaid expenses and other | (10,667,535) | 1,412,833 |
| | <u>(34,248,329)</u> | <u>(15,345,994)</u> |
| Increase (decrease) in operating liabilities: | | |
| Accounts payable | (634,444) | 8,288,333 |
| Interest payable | 84,430 | 82,294 |
| Payroll-related accruals | 3,250,854 | 7,516,913 |
| Due to third-party payors | 5,946,752 | (1,275,321) |
| Other accrued expenses | 281,088 | (620,830) |
| | <u>8,928,680</u> | <u>13,991,389</u> |
| Change in working capital other than cash and cash equivalents | <u>\$ (25,319,649)</u> | <u>\$ (1,354,605)</u> |

The Danbury Hospital and Subsidiary

Notes to Consolidated Financial Statements (continued)

12. 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 | |
|----------------------------|-------------------------|-----------------------|
| | 2014 | 2013 |
| Health care services | \$ 430,165,149 | \$ 413,105,237 |
| General and administrative | 84,744,781 | 82,065,518 |
| | <u>\$ 514,909,930</u> | <u>\$ 495,170,755</u> |

13. Other Operating Revenue

Other operating revenue consisted of the following:

| | Year Ended September 30 | |
|--|-------------------------|----------------------|
| | 2014 | 2013 |
| Captive malpractice insurance premiums | \$ 14,521,599 | \$ 7,313,048 |
| Captive investment income | 1,272,580 | 1,177,798 |
| Rental income | 3,264,808 | 2,895,594 |
| Education | 1,642,376 | 1,602,413 |
| Grants | 3,118,792 | 3,238,726 |
| Research | 478,467 | 209,902 |
| EHR incentive payments | 752,720 | 1,832,059 |
| Other income | 572,358 | 538,000 |
| | <u>\$ 25,623,700</u> | <u>\$ 18,807,540</u> |

14. Subsequent Events

Subsequent events have been evaluated through February 27, 2015, which represents the date the consolidated financial statements were issued. Except as disclosed below, no events have occurred that require disclosure in or adjustment to the consolidated financial statements.

On October 1, 2014, the Hospital received a single provider license to include New Milford Hospital. As a result, the operations of New Milford Hospital became a department of the Hospital effective October 1, 2014, and all assets and liabilities were transferred to the Hospital on that date. New Milford Hospital became an inactive entity as of October 1, 2014.

Supplementary Information

The Danbury Hospital and Subsidiary
Consolidating Balance Sheets

| | September 30, 2014 | | | | September 30, 2013 | | | |
|---|-------------------------|--|------------------------------------|--------------------|-------------------------|--|------------------------------------|--------------------|
| | The Danbury Hospital | Western Connecticut Health Network Insurance Co., Ltd. | Adjustments and Eliminations | Total | The Danbury Hospital | Western Connecticut Health Network Insurance Co., Ltd. | Adjustments and Eliminations | Total |
| Assets: | | | | | | | | |
| Current assets: | | | | | | | | |
| Cash and cash equivalents | \$ 46,609,541 | \$ 2,499,988 | \$ - | \$ 49,109,529 | \$ 58,568,767 | \$ 962,642 | \$ - | \$ 59,531,409 |
| Current portion of assets limited as to use of \$13,480,000 in 2014 and \$14,833,000 in 2013 | 1,868,637 | 7,995,000 | - | 9,863,637 | 1,189,827 | 3,800,000 | - | 4,989,827 |
| Accounts receivable, less allowance for uncollectible accounts | 63,595,267 | - | - | 63,595,267 | 57,504,970 | - | - | 57,504,970 |
| Current portion of due from related parties | 7,540,267 | - | (123,090) | 7,417,177 | 7,036,124 | - | (13,367) | 7,022,757 |
| Inventories | 10,027,585 | - | - | 10,027,585 | 9,521,995 | - | - | 9,521,995 |
| Prepaid expenses and other | 7,591,258 | 16,048,064 | - | 23,639,322 | 8,631,701 | 4,856,340 | - | 13,488,041 |
| Total current assets | 137,232,555 | 26,543,052 | (123,090) | 163,652,517 | 142,453,384 | 9,618,982 | (13,367) | 152,058,999 |
| Assets limited as to use: | | | | | | | | |
| Construction funds | - | - | - | - | 45,694,876 | - | - | 45,694,876 |
| Investment in WCHNIC | - | 97,159,849 | - | 97,159,849 | - | 58,410,610 | - | 58,410,610 |
| Total noncurrent assets limited as to use | - | 97,159,849 | - | 97,159,849 | 45,694,876 | 58,410,610 | - | 104,105,486 |
| Investments | 204,451,643 | - | - | 204,451,643 | 199,169,615 | - | - | 199,169,615 |
| Other assets | 782,530 | - | - | 782,530 | 195,539 | - | - | 195,539 |
| Due from related parties | 904,678 | - | - | 904,678 | 5,739,847 | - | - | 5,739,847 |
| Investment in Western Connecticut Health Network Insurance Co., Ltd. | 41,436,021 | - | (41,436,021) | - | 21,618,215 | - | (21,618,215) | - |
| Interest in Western Connecticut Health Network Foundation, Inc. | 97,632,022 | - | - | 97,632,022 | 106,193,031 | - | - | 106,193,031 |
| Property, plant, and equipment: | | | | | | | | |
| Land and land improvements | 10,667,284 | - | - | 10,667,284 | 9,964,052 | - | - | 9,964,052 |
| Buildings and building improvements | 428,286,085 | - | - | 428,286,085 | 293,253,282 | - | - | 293,253,282 |
| Equipment and other | 251,398,149 | - | - | 251,398,149 | 222,804,495 | - | - | 222,804,495 |
| Construction-in-progress (estimated cost to complete at September 30, 2014: \$12,424,000) | 17,786,049 | - | - | 17,786,049 | 105,866,676 | - | - | 105,866,676 |
| 708,137,567 | - | - | 708,137,567 | 631,888,505 | - | - | 631,888,505 | |
| Less accumulated depreciation | 356,467,852 | - | - | 356,467,852 | 328,300,919 | - | - | 328,300,919 |
| Bond issuance costs, net | 351,669,715 | - | - | 351,669,715 | 303,587,586 | - | - | 303,587,586 |
| Total assets | \$ 4,611,155 | \$ 123,702,901 | \$ (41,559,111) | \$ 920,864,109 | \$ 829,751,638 | \$ 68,029,592 | \$ (21,631,582) | \$ 876,149,648 |

Continued on next page.

The Danbury Hospital and Subsidiary
Consolidating Balance Sheets (continued)

| | September 30, 2014 | | | | September 30, 2013 | | | |
|--------------------------------------|-------------------------|----------------|--|----------------|-------------------------|-----------------|--|----------------|
| | The Danbury Hospital | | Western Connecticut Health Network Insurance Co., Ltd. | | The Danbury Hospital | | Western Connecticut Health Network Insurance Co., Ltd. | |
| | | | Adjustments and Eliminations | Total | | | Adjustments and Eliminations | Total |
| Liabilities and net assets: | | | | | | | | |
| Current liabilities: | | | | | | | | |
| Accounts payable | \$ 33,072,961 | \$ 36,767 | \$ - | \$ 33,109,728 | \$ 33,727,097 | \$ 17,075 | \$ - | \$ 33,744,172 |
| Payroll-related accruals | 31,635,886 | - | - | 31,635,886 | 28,385,032 | - | - | 28,385,032 |
| Due to affiliates | - | 123,090 | (123,090) | - | - | 13,367 | (13,367) | - |
| Due to third-party payors | 14,656,782 | - | - | 14,656,782 | 8,710,030 | - | - | 8,710,030 |
| Interest payable | 1,791,204 | - | - | 1,791,204 | 1,706,774 | - | - | 1,706,774 |
| Other accrued expenses | 3,214,245 | - | - | 3,214,245 | 2,933,157 | - | - | 2,933,157 |
| Current portion of long-term debt | 4,925,000 | - | - | 4,925,000 | 2,880,000 | - | - | 2,880,000 |
| Total current liabilities | 89,296,078 | 159,857 | (123,090) | 89,332,845 | 78,342,090 | 30,442 | (13,367) | 78,359,165 |
| Self-insurance liabilities | - | 82,107,023 | - | 82,107,023 | - | 46,380,935 | - | 46,380,935 |
| Other long-term liabilities | 18,355,703 | - | - | 18,355,703 | 18,062,437 | - | - | 18,062,437 |
| Long-term debt, less current portion | 241,775,000 | - | - | 241,775,000 | 246,700,000 | - | - | 246,700,000 |
| Total liabilities | 349,426,781 | 82,266,880 | (123,090) | 431,570,571 | 343,104,527 | 46,411,377 | (13,367) | 389,502,537 |
| Net assets: | | | | | | | | |
| Share capital | - | 12,000 | (12,000) | - | - | 12,000 | (12,000) | - |
| Additional paid-in capital | - | 12,863,333 | (12,863,333) | - | - | 8,663,332 | (8,663,332) | - |
| Unrestricted | 412,096,873 | 28,500,688 | (28,500,688) | 412,096,873 | 400,930,008 | 12,942,883 | (12,942,883) | 400,930,008 |
| Temporarily restricted | 47,726,160 | - | - | 47,726,160 | 56,603,735 | - | - | 56,603,735 |
| Permanently restricted | 29,470,505 | - | - | 29,470,505 | 29,113,368 | - | - | 29,113,368 |
| Total net assets | 489,293,538 | 41,436,021 | (41,436,021) | 489,293,538 | 486,647,111 | 21,618,215 | (21,618,215) | 486,647,111 |
| Total liabilities and net assets | \$ 838,720,319 | \$ 123,702,901 | \$ (41,559,111) | \$ 920,864,109 | \$ 829,751,638 | \$ (68,029,592) | \$ (21,631,582) | \$ 876,149,648 |

The Danbury Hospital and Subsidiary

Consolidating Statements of Operations and Changes in Net Assets

| | September 30, 2014 | | | | September 30, 2013 | | | | |
|---|-------------------------|------------------------------------|--|------------------------------------|-------------------------|------------------------------------|--|------------------------------------|----------------|
| | The Danbury Hospital | | Western Connecticut Health Network Insurance Co., Ltd. | | The Danbury Hospital | | Western Connecticut Health Network Insurance Co., Ltd. | | |
| | | Adjustments and Eliminations | | Adjustments and Eliminations | | Adjustments and Eliminations | | Adjustments and Eliminations | |
| Unrestricted revenues: | | | | | | | | | |
| Net patient service revenue | \$ 521,477,663 | \$ - | \$ - | \$ 521,477,663 | \$ 518,977,309 | \$ - | \$ - | \$ 518,977,309 | \$ 518,977,309 |
| Provision for uncollectible accounts | 16,984,907 | - | - | 16,984,907 | 19,104,169 | - | - | 19,104,169 | 19,104,169 |
| Net patient service revenue less provision for uncollectible accounts | 504,492,756 | - | - | 504,492,756 | 499,873,140 | - | - | 499,873,140 | 499,873,140 |
| Net assets released from restriction | 5,665,862 | - | - | 5,665,862 | 5,221,901 | - | - | 5,221,901 | 5,221,901 |
| Other operating revenues | 9,829,521 | 23,289,920 | (7,495,741) | 25,623,700 | 10,316,694 | 13,846,966 | (5,356,120) | 18,807,540 | 18,807,540 |
| | 519,988,139 | 23,289,920 | (7,495,741) | 535,782,318 | 515,411,735 | 13,846,966 | (5,356,120) | 523,902,581 | 523,902,581 |
| Expenses: | | | | | | | | | |
| Salaries, benefits, and fees | 300,891,797 | - | - | 300,891,797 | 298,251,765 | - | - | 298,251,765 | 298,251,765 |
| Supplies and other | 163,216,717 | 466,286 | (7,495,741) | 156,187,262 | 152,309,380 | 238,760 | (5,356,120) | 147,192,020 | 147,192,020 |
| Insurance | - | 21,591,676 | - | 21,591,676 | - | 15,709,626 | - | 15,709,626 | 15,709,626 |
| Depreciation and amortization | 31,682,167 | - | - | 31,682,167 | 30,033,213 | - | - | 30,033,213 | 30,033,213 |
| Interest | 4,557,028 | - | - | 4,557,028 | 3,984,131 | - | - | 3,984,131 | 3,984,131 |
| Income (loss) from operations | 500,347,709 | 22,057,962 | (7,495,741) | 514,909,930 | 484,578,489 | 15,948,386 | (5,356,120) | 495,170,755 | 495,170,755 |
| | 19,640,430 | 1,231,958 | - | 20,872,388 | 30,833,246 | (2,101,420) | - | 28,731,826 | 28,731,826 |
| Nonoperating income (loss): | | | | | | | | | |
| Investment income, net | 3,546,237 | - | - | 3,546,237 | 4,504,328 | - | - | 4,504,328 | 4,504,328 |
| Change in unrealized gains and losses on investments | 11,254,037 | 3,132,267 | (3,132,267) | 11,254,037 | 5,199,125 | 475,271 | (475,271) | 5,199,125 | 5,199,125 |
| Loss on early extinguishment of debt | - | - | - | - | - | - | - | - | - |
| Change in equity interest in unrestricted net assets of the Western Connecticut Health Network Foundation, Inc. | (40,571) | - | - | (40,571) | 206,244 | - | - | 206,244 | 206,244 |
| Change in investment in WCHNIC | 16,685,537 | - | (16,685,537) | - | (2,101,420) | - | 2,101,420 | - | - |
| | 31,445,240 | 3,132,267 | (19,817,804) | 14,759,703 | 7,808,277 | 475,271 | 1,626,149 | 9,909,697 | 9,909,697 |
| Excess (deficiency) of revenues over expenses | \$ 51,085,670 | \$ 4,364,225 | \$ (19,817,804) | \$ 35,632,091 | \$ 38,641,523 | \$ (1,626,149) | \$ 1,626,149 | \$ 38,641,523 | \$ 38,641,523 |

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2014 Ernst & Young LLP.
All Rights Reserved.

ey.com

