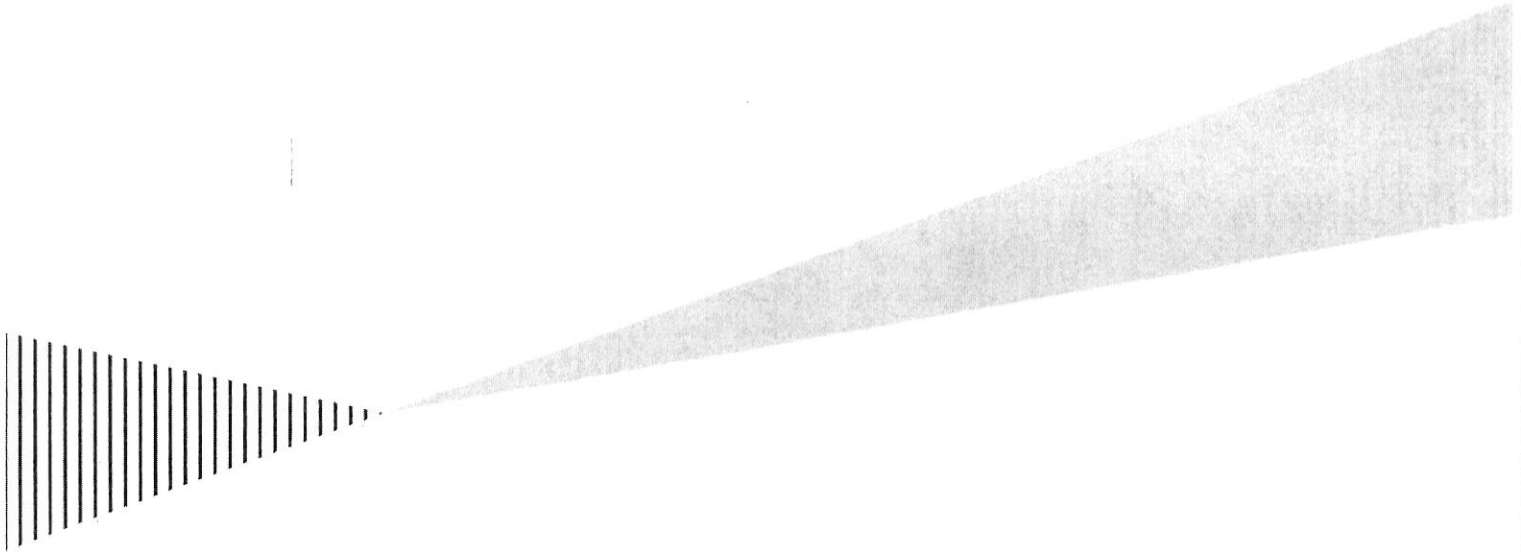


CONSOLIDATED FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

Western Connecticut Health Network, Inc. and Subsidiaries  
Years Ended September 30, 2014 and 2013  
with Report of Independent Auditors

Ernst & Young LLP



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Western Connecticut Health Network, Inc. and Subsidiaries

Consolidated Financial Statements  
and Supplementary Information

Years Ended September 30, 2014 and 2013

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## Report of Independent Auditors

The Board of Directors  
Western Connecticut Health Network, Inc.

We have audited the accompanying consolidated financial statements of Western Connecticut Health Network, Inc. and Subsidiaries, 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. (the Company), a wholly-owned subsidiary, which statements reflect total assets constituting 8% and 7% as of September 30, 2014 and 2013, respectively, and total revenues constituting 2% in 2014 and 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 the Company, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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



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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 Western Connecticut Health Network, Inc. and Subsidiaries 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 consolidated 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 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.

*Ernst + Young LLP*

February 27, 2015

Western Connecticut Health Network, Inc. and Subsidiaries  
Consolidated Balance Sheets

	September 30	
	2014	2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 144,314,483	\$ 71,777,507
Investments	14,004,464	-
Current portion of assets limited as to use	9,863,637	6,189,827
Current portion of pledges receivable	16,375,353	13,627,769
Accounts receivable, less allowance for uncollectible accounts of approximately \$43,007,000 in 2014 and \$20,592,000 in 2013	128,633,349	76,374,995
Inventories	14,459,240	11,258,609
Prepaid expenses and other	30,762,442	15,085,296
Total current assets	358,412,968	194,314,003
Investments	335,990,944	210,803,720
Assets limited as to use:		
Funds restricted by donor	83,512,045	47,560,728
Board designated funds	10,115,833	9,422,297
Beneficial interests in trusts held by others and charitable remainder trust	15,765,862	7,593,627
Construction funds	23,405,407	45,694,876
Investments held by Western Connecticut Health Network Insurance Co., Ltd.	97,159,849	58,410,610
Total noncurrent assets limited as to use	229,958,996	168,682,138
Other assets	28,093,580	16,815,682
Property, plant, and equipment:		
Land and land improvements	40,541,270	11,897,212
Buildings and building improvements	692,523,365	352,295,400
Equipment and other	585,356,351	283,476,026
Construction in progress (estimated cost to complete at September 30, 2014: \$55,127,000)	108,748,595	110,954,585
	1,427,169,581	758,623,223
Less accumulated depreciation	775,229,849	408,828,028
	651,939,732	349,795,195
Pledges receivable, less current portion	21,130,461	27,663,400
Bond issuance costs, net	4,611,155	5,099,525
Total assets	\$ 1,630,137,836	\$ 973,173,663

	September 30	
	2014	2013
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 71,619,930	\$ 35,556,138
Payroll-related accruals	69,089,102	44,842,213
Due to third-party payors	53,635,921	10,798,195
Interest payable	2,573,435	1,706,774
Other accrued expenses	4,373,099	4,131,560
Current portion of long-term debt and capital lease obligations	11,964,141	2,880,000
Total current liabilities	<u>213,255,628</u>	<u>99,914,880</u>
Self-insurance liabilities	86,031,950	46,380,935
Accrued pension liabilities and other	169,569,725	79,978,708
Long-term debt and capital lease obligations, less current portion	363,726,412	246,700,000
Total liabilities	<u>832,583,715</u>	<u>472,974,523</u>
Net assets:		
Unrestricted	659,346,055	404,480,146
Unrestricted attributable to noncontrolling interest	2,005,199	-
Temporarily restricted	92,944,545	62,336,151
Permanently restricted	43,258,322	33,382,843
Total net assets	<u>797,554,121</u>	<u>500,199,140</u>

Total liabilities and net assets

\$ 1,630,137,836    \$ 973,173,663

*See accompanying notes.*

Western Connecticut Health Network, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended September 30	
	2014	2013
Unrestricted revenues:		
Net patient service revenue	\$ 1,002,037,320	\$ 715,654,985
Provision for uncollectible accounts	43,748,341	24,432,854
Net patient service revenue less provision for uncollectible accounts	958,288,979	691,222,131
Net assets released from restriction	7,155,684	5,514,055
Other operating revenue	25,099,816	13,364,145
	990,544,479	710,100,331
Expenses:		
Salaries, benefits and fees	583,142,822	435,608,640
Supplies and other	294,213,121	194,336,128
Insurance	20,861,003	15,709,626
Depreciation and amortization	53,445,138	37,300,840
Interest	6,326,466	4,067,031
	957,988,550	687,022,265
Operating income	32,555,929	23,078,066
Income tax (expense) credit	(106,501)	158,546
Nonoperating gains (losses):		
Contributions	5,517,373	653,873
Investment income, net	5,772,965	7,054,057
Change in unrealized gains and losses on investments	15,876,394	5,596,197
Contribution received in the acquisition of Norwalk Health Services Corporation and Subsidiaries	296,901,287	-
Operating expenses of the Western Connecticut Health Network Foundation, Inc. and Norwalk Hospital Foundation, Inc.	(3,520,010)	(2,818,144)
Interest rate swap activity:		
Interest cost on interest rate swap	(161,828)	-
Change in value of interest rate swap	(2,502,627)	-
	(2,664,455)	-
	317,883,554	10,485,983
Excess of revenues over expenses before noncontrolling interest in joint venture	350,332,982	33,722,595
Less: net income attributable to noncontrolling interest in joint venture	(1,116,608)	-
Excess of revenues over expenses	349,216,374	33,722,595

*Continued on next page.*

Western Connecticut Health Network, Inc. and Subsidiaries

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)	\$ 349,216,374	\$ 33,722,595
Net assets released from restrictions for property, plant and equipment	19,844,315	6,015,256
Transfer to temporarily restricted net assets	(563,608)	(17,619)
Change in pension funding obligations	(111,966,693)	87,663,133
Net unrestricted other changes in joint venture	(598,746)	-
Non-controlling interest in joint venture	1,116,608	-
Other	(177,142)	7,596
Increase in unrestricted net assets	256,871,108	127,390,961
Temporarily restricted net assets:		
Contributions	12,290,662	36,343,043
Investment income, net	1,714,730	3,216,913
Change in unrealized gains and losses on investments	3,123,483	409,999
Contribution received in the acquisition of Norwalk Health Services Corporation and Subsidiaries	39,887,462	-
Change in beneficial interest in charitable remainder trust	425,357	-
Net assets released from restriction	(7,155,684)	(5,514,055)
Net assets released from restrictions for property, plant and equipment	(19,844,315)	(6,015,256)
Transfer from unrestricted and permanently restricted net assets	444,936	92,474
Other	(278,237)	(23,071)
Increase in temporarily restricted net assets	30,608,394	28,510,047
Permanently restricted net assets:		
Increase in beneficial interest in trusts held by others	164,071	330,996
Contributions	131,084	167,410
Contribution received in the acquisition of Norwalk Health Services Corporation and Subsidiaries	9,461,652	-
Transfer from (to) temporarily restricted net assets	118,672	(74,855)
Increase in permanently restricted net assets	9,875,479	423,551
Increase in net assets	297,354,981	156,324,559
Net assets at beginning of year	500,199,140	343,874,581
Net assets at end of year	\$ 797,554,121	\$ 500,199,140

*See accompanying notes.*



Western Connecticut Health Network, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended September 30	
	2014	2013
<b>Operating activities</b>		
Increase in net assets	\$ 297,354,981	\$ 156,324,559
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	53,445,138	37,300,840
Change in unrealized gains and losses on investments	(18,999,877)	(6,006,196)
Change in pension funding obligations	111,966,693	(87,663,133)
Other changes in net assets	455,379	15,475
Restricted contributions and investment income	(14,136,476)	(39,727,366)
Change in beneficial interest in trusts held by others and charitable remainder trust	(589,428)	(330,996)
Provision for uncollectible accounts	43,748,341	24,432,854
Contribution received in the acquisition of Norwalk Health Services Corporation and Subsidiaries	(346,250,401)	-
Changes in operating assets and liabilities (see Note 12)	(83,804,709)	(55,181,792)
Net cash provided by operating activities	43,189,641	29,164,245
<b>Investing activities</b>		
Additions to property, plant, and equipment, net	(142,041,019)	(101,338,142)
Cash received from the acquisition of Norwalk Health Services Corporation and Subsidiaries	83,042,680	-
Decrease in investments, net and assets limited as to use	78,435,740	33,203,933
Net cash provided by (used in) investing activities	19,437,401	(68,134,209)
<b>Financing activities</b>		
Proceeds from issuance of long-term debt	3,020,470	-
Payments of long-term debt	(7,247,012)	(3,063,855)
Restricted contributions and investment income	14,136,476	39,727,366
Net cash provided by financing activities	9,909,934	36,663,511
Net increase (decrease) in cash and cash equivalents	72,536,976	(2,306,453)
Cash and cash equivalents at beginning of year	71,777,507	74,083,960
Cash and cash equivalents at end of year	\$ 144,314,483	\$ 71,777,507

See accompanying notes.

# Western Connecticut Health Network, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

September 30, 2014

### 1. Summary of Significant Accounting Policies

#### Organization and Basis of Presentation

Western Connecticut Health Network, Inc. (the Network) was established under the statutes of the State of Connecticut and is the parent company of the following subsidiaries: The Danbury Hospital and Subsidiary (Danbury Hospital); Western Connecticut Health Network Foundation, Inc. (WCHNF); Western Connecticut Health Network Affiliates, Inc. (WCHNA); Business System, Inc. (BSI); Western Connecticut Home Care, Inc. (WCHC); The New Milford Hospital Inc. (New Milford Hospital); Western Connecticut Medical Group, P.C. (WCMG) and Eastern New York Medical Services, P.C. (ENYMS).

Effective January 1, 2014, Norwalk Health Services Corporation (NHSC) was acquired by the Network. Refer to the Norwalk Health Services Corporation Acquisition section of this note.

The Network owns 100% of the capital stock of BSI. The Network is the sole corporate member of Danbury Hospital, WCHNF, New Milford Hospital, WCHNA, WCHC, WCMG and NHSC.

Danbury Hospital is a voluntary, not-for-profit organization incorporated under the General Statutes of the State of Connecticut. The Board of Danbury Hospital is appointed by the Network. The consolidated financial statements of Danbury Hospital include its wholly owned subsidiary, Western Connecticut Health Network Insurance Co., Ltd. (WCHNIC).

New Milford Hospital is a voluntary, not-for-profit organization incorporated under the General Statutes of the State of Connecticut.

WCMG is established under the General Statutes of the State of Connecticut and provides physician services to patients primarily from Western Connecticut and Southeastern New York. WCMG also provides physician support to various Network affiliates.

Effective April 1, 2013, ENYMS, a New York professional corporation established under the General Statutes of the State of New York, was formed. It provides medical services through physicians and other licensed health care providers to the general public from offices located in Westchester County, New York.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

##### Norwalk Health Services Corporation Acquisition

On January 1, 2014 (the Transaction Date), the Network entered into an affiliation agreement, whereby, the Network became the sole corporate member of NHSC, a system of health care affiliates that provides a wide array of services throughout the region including Norwalk Hospital Association (Norwalk Hospital) and its majority interest in the Norwalk Surgery Center, LLC; Norwalk Physician and Surgeons, Inc. (NHP&S); Norwalk Health Care, Inc. (NHC); Norwalk Hospital Foundation, Inc. (NHF); SWC Corporation and Maple Street Indemnity Corporation (MSI). The Network acquired NHSC by means of an inherent contribution where no consideration was transferred by the Network. Subsequent to the Transaction Date, MSI, NHSC's wholly owned captive insurance company, merged with WCHNIC on March 1, 2014. On September 30, 2014, a grant agreement was entered into between NHSC and Norwalk Hospital by which an amount equal to all NHSC's assets and liabilities were transferred to Norwalk Hospital.

Norwalk Hospital is a voluntary, not-for-profit organization incorporated under the General Statutes of the State of Connecticut.

The Network accounted for this business combination by applying the acquisition method and, accordingly, the inherent contribution received was valued as the excess of assets acquired over liabilities assumed. In determining the inherent contribution received, all assets acquired and liabilities assumed were measured at fair value as of the Transaction Date. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the Transaction Date.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

	<u>January 1, 2014</u>
<b>Assets</b>	
Cash and cash equivalents	\$ 83,042,680
Short-term investments	33,670,156
Current portion of pledges receivable	1,764,522
Accounts receivable, net of allowance for uncollectible accounts	32,333,256
Inventories	2,867,344
Prepaid expenses and other	3,649,233
Investments	135,776,736
Funds restricted by donor	35,545,597
Beneficial interest in charitable remainder trust	7,582,807
Construction funds	50,868,874
Other assets	29,994,650
Property, plant and equipment, net	213,060,286
Pledges receivable, less current portion	4,456,515
Total assets acquired	<u>634,612,656</u>
<b>Liabilities</b>	
Accounts payable	38,157,830
Payroll-related accruals	18,133,408
Due to third-party payors	36,361,957
Interest payable	357,513
Current portion of long-term debt and capital lease obligations	5,346,883
Self-insurance liabilities	52,319,000
Accrued pension liabilities and other	12,695,452
Long-term debt and capital lease obligation, less current portion	124,990,212
Total liabilities assumed	<u>288,362,255</u>
Excess of assets acquired over liabilities assumed	<u>\$ 346,250,401</u>
<b>Net assets acquired</b>	
Unrestricted	\$ 296,901,287
Temporarily restricted	39,887,462
Permanently restricted	9,461,652
	<u>\$ 346,250,401</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**1. Summary of Significant Accounting Policies (continued)**

The following table summarizes the excess of revenues over expenses and changes in net assets attributable to NHSC from the Transaction Date through September 30, 2014 that are included in the accompanying 2014 consolidated financial statements.

	Period from January 1, 2014 to September 30, 2014
Excess of revenues over expenses	\$ 19,084,314
Change in net assets:	
Unrestricted net assets	(22,951,858)
Temporarily restricted net assets	(7,524,716)
Permanently restricted net assets	-
Total change in net assets	\$ (30,476,574)

The following table represents unaudited pro forma financial information for the Network, assuming the affiliation with NHSC had taken place on October 1, 2012. The pro forma financial information is not necessarily indicative of the results of operations as they would have been had the affiliation been effective on October 1, 2012.

	Year Ended September 30	
	2014	2013
Excess of revenues over expenses	\$ 69,992,242	\$ 58,488,932
Change in net assets:		
Unrestricted net assets	\$ (5,654,475)	\$219,340,820
Temporarily restricted net assets	(7,234,046)	24,777,211
Permanently restricted net assets	420,627	432,551
Total change in net assets	\$ 12,467,894	\$ 244,550,582

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

The consolidated financial statements include the accounts of the Network, Danbury Hospital, WCHNF, New Milford Hospital, WCHNA, BSI, WCHC, WCMG, ENYMS, Norwalk Hospital, NHP&S, NHF, NHC and SWC Corporation. All material intercompany transactions have been eliminated in consolidation.

#### **Use of Estimates**

The preparation of consolidated 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 Network 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 Network's policy to monitor the financial strength of these institutions.

#### **Investments**

The Network'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 or loss is restricted by donor or by law.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

Alternative investments (nontraditional, not-readily-marketable assets), some of which are structured such that the Network 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 nonmarketable and market-traded securities. Valuations of these investments and, therefore, the Network's holdings, may be determined by the investment manager or general partner, and "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 Network accounts for these investments using the equity method of accounting, except for investments held by the defined benefit pension plans, and reports its share of the increase or decrease in the funds' value as investment gain or loss. Alternative investments held by the defined benefit pension plans are reported at fair value as estimated in an unquoted market. 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 Network's annual consolidated financial statement reporting.

#### Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Network 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 and beneficial interest in charitable remainder trust. Permanently restricted net assets, which are primarily endowment gifts and beneficial interest in trusts held by others, have been restricted by donors, and are to be maintained in perpetuity.

#### Contributions

For financial statement purposes, the Network distinguishes between contributions of unrestricted assets, temporarily restricted assets, and permanently restricted assets.

Contributions for which donors have not stipulated restrictions, as well as contributions for which donors have stipulated restrictions, but which are met within the same reporting period, are reported as unrestricted support. Contributions, for which donors have imposed restrictions which limit the use of the donated assets, are reported as temporarily restricted net assets if the restrictions are not met in the same reporting period. When such donor imposed restrictions are met in subsequent reporting periods, temporarily restricted net assets are reclassified to

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

unrestricted net assets and reported as net assets released from restrictions. Contributions of assets which donors have stipulated must be maintained in perpetuity, with only the income earned thereon available for current use, are classified as permanently restricted net assets.

#### Patient Accounts Receivable

Patient accounts receivable result from the health care services provided by the Network. 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 Network'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 Network's collection efforts. The Network'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 Network 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; and
- Trending of days revenue in accounts receivable

The Network 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.



## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

The Network'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 Network 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 32% and 13%, and 33% and 12%, for Medicare and Medicaid, respectively, at September 30, 2014 and 2013, respectively.

#### **Assets Limited as to Use**

Assets limited as to use represent investments with donor restrictions; unrestricted 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); beneficial interest in trusts held by others in accordance with donor restrictions; beneficial interest in charitable remainder trust; 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.

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

Property, plant and equipment are recorded at cost. The Network 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 remaining useful lives range from 1-42 years.

Conditional asset retirement obligations amounted to \$9,086,518 and \$377,224 as of September 30, 2014 and 2013, respectively. These obligations are recorded in accrued pension liabilities and other 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**

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 were \$1,322,065 and \$1,019,449 at September 30, 2014 and 2013, respectively.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

##### **Inventories**

Danbury Hospital and Norwalk Hospital use the first in, first out method, in the valuation of inventory. Inventories used in general operations of New Milford Hospital are stated at average cost.

##### **Nonoperating Gains (Losses)**

Activities, other than in connection with providing health care services, are considered to be nonoperating. Nonoperating gains (losses) primarily consist of contributions, including the inherent contribution related to the NHSC acquisition, investment income, realized and unrealized gains and losses on investments, interest rate swap activity and the operating expenses of WCHNF and NHF.

##### **Excess of Revenues Over Expenses**

The consolidated statements of operations and changes in net assets include excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, include permanent transfers of assets for other than goods and services, contributions of long-lived assets, changes in pension funding obligations, and the non-controlling interest in a joint venture.

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

##### **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 the Network's financial instruments are disclosed in the respective notes and/or in Note 4. Investments include certificates of deposit with original maturities in excess of three months.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

##### Income Taxes

The Network comprises not-for-profit corporations, with the exception of BSI, WCHNIC, SWC Corporation and ENYMS, 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 Network is also exempt from state and local taxes. BSI, ENYMS and SWC Corporation are for-profit corporations and WCHNIC is a foreign corporation exempt from US taxation and is not subject to taxes under the Cayman Islands tax concessions law. BSI dissolved on April 17, 2014 and did not have any material operations prior to dissolution.

At September 30, 2014, the Network has net operating loss carryforwards from unrelated business activities of approximately \$50,382,000 which will begin expiring in 2018. A deferred tax asset for these losses of approximately \$20,153,000 is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future periods. SWC Corporation has a capital loss carryforward of approximately \$2,480,000. A deferred tax asset for these losses of approximately \$992,000 is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future years. The Network also has a receivable of approximately \$133,000 related to BSI for federal and state taxes. For ENYMS and SWC Corporation, the tax provision and any subsequent liability is not material to the consolidated financial statements.

##### 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 Network 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 Network recognized \$2,332,496 and \$1,832,059 of EHR revenues during its fiscal year ended September 30, 2014 and 2013, respectively, comprised of \$371,393 and \$271,467 of Medicaid revenues and \$1,961,103 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.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

The Network'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.

#### Reclassifications

Certain reclassifications have been made to the year ended September 30, 2013 balances previously reported in the consolidated balance sheets and consolidated statements of operations and changes in net assets in order to conform with the year ended September 30, 2014 presentation.

#### New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board ("FASB") 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.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

The following table summarizes net patient service revenue:

	Year Ended September 30	
	2014	2013
Gross patient service revenue	\$ 2,462,700,883	\$ 1,675,013,713
Deductions:		
Allowances	1,433,142,811	943,746,574
Charity care (at charges)	27,520,752	15,612,154
	<u>1,460,663,563</u>	<u>959,358,728</u>
Net patient service revenue	1,002,037,320	715,654,985
Provision for uncollectible accounts	43,748,341	24,432,854
Net patient service revenue less provision for uncollectible accounts	<u>\$ 958,288,979</u>	<u>\$ 691,222,131</u>

During 2014 and 2013, approximately 39% and 9%, and 32% and 7%, 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 Network 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 Network.

The Network has agreements with third-party payors that provide for payments 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 such audits,

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

reviews and investigations. During 2014 and 2013, the Network recorded an increase (decrease) in net patient service revenue of approximately \$783,000 and (\$490,000), respectively, related to changes in previously estimated third-party payor settlements.

The Network 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 Network specific data. Such amounts are included in the accompanying consolidated balance sheets.

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

	Year Ended September 30	
	2014	2013
Third-party payors	\$ 964,682,978	\$ 688,202,926
Self-pay patients	37,354,342	27,452,059
	<u>\$ 1,002,037,320</u>	<u>\$ 715,654,985</u>

It is the policy of the Network 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 Network. A patient is classified as a charity care patient by reference to established policies of the Network. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Network 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. These charges are not included in net patient service revenue for financial reporting purposes.

The estimated cost of charity care provided was approximately \$10,362,000 and \$7,192,000 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 Network specific data.

Western Connecticut Health Network, Inc. and Subsidiaries

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	\$ 90,666,168	\$ 57,474,645
Common collective funds	115,554,515	123,274,892
Fixed income securities	16,122,947	52,640,414
Mutual funds	310,049,197	110,145,986
Real estate/commodities	1,851,275	693,107
Alternative investments (at equity method)	39,808,077	32,653,014
	<u>\$ 574,052,179</u>	<u>\$ 376,882,058</u>

Also included within assets limited as to use is \$1,200,000 of land held for sale as of September 30, 2013 and beneficial interest in trusts held by others and charitable remainder trusts of \$15,765,862 and \$7,593,627 as of September 30, 2014 and 2013, respectively.

Investment income included in non-operating gains for the year ended September 30, 2014 and 2013 consists of:

	2014	2013
Interest and dividend income	\$ 4,729,442	\$ 3,604,933
Realized gains and losses, net and equity income on alternative investments	1,043,523	3,449,124
	<u>\$ 5,772,965</u>	<u>\$ 7,054,057</u>

**4. Fair Values of Financial Instruments**

For assets and liabilities required to be measured at fair value, the Network 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 Network'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.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

The Network 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 Network 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.



Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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

	September 30, 2014			Total
	Level 1	Level 2	Level 3	
<b>Cash and cash equivalents</b>	\$ 144,314,483	\$ —	\$ —	\$ 144,314,483
<b>Investments and assets limited as to use:</b>				
Cash and cash equivalents	90,666,168	—	—	90,666,168
Mutual funds:				
Fixed income	310,049,197	—	—	310,049,197
Common collective funds:				
Domestic equity	494,177	86,115,208	—	86,609,385
International equity	62,745	25,690,956	—	25,753,701
Other	—	3,191,429	—	3,191,429
Securities:				
Fixed income	8,515,250	7,607,697	—	16,122,947
Real estate/commodities	93,124	1,758,151	—	1,851,275
<b>Beneficial interest in trusts held by others and charitable remainder trust:</b>				
Cash and cash equivalents	855,914	—	—	855,914
Mutual funds:				
Domestic equity	3,144,160	—	—	3,144,160
International equity	2,997,427	—	—	2,997,427
Fixed income	2,400,020	—	—	2,400,020
Common collective funds:				
Domestic equity	—	2,058,023	—	2,058,023
International equity	—	770,975	—	770,975
Fixed income	—	362,245	—	362,245
Corporate and foreign bonds	—	113,394	—	113,394
Real estate/commodities	—	1,047,566	—	1,047,566
Other	1,052,988	963,150	—	2,016,138
<b>Other assets:</b>				
Interest rate swap	—	2,510,102	—	2,510,102
	<u>\$ 564,645,653</u>	<u>\$ 132,188,896</u>	<u>\$ —</u>	<u>\$ 696,834,549</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Fair Values of Financial Instruments (continued)

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 71,777,507	\$ -	\$ -	\$ 71,777,507
<b>Investments and assets limited as to use:</b>				
Cash and cash equivalents	57,474,645	-	-	57,474,645
Mutual funds:				
Fixed income	110,145,986	-	-	110,145,986
Common collective funds:				
Domestic equity	-	96,043,547	-	96,043,547
International equity	-	24,286,338	-	24,286,338
Other	-	2,945,007	-	2,945,007
Securities:				
Fixed income	39,965,010	12,675,404	-	52,640,414
Real estate/commodities	-	693,107	-	693,107
<b>Beneficial interest in trusts held by others:</b>				
Cash and cash equivalents	350,454	-	-	350,454
Mutual funds:				
Domestic equity	929,298	-	-	929,298
International equity	924,608	-	-	924,608
Fixed income	743,256	-	-	743,256
Common collective funds:				
Domestic equity	-	2,033,730	-	2,033,730
International equity	-	509,542	-	509,542
Fixed income	-	472,498	-	472,498
Corporate and foreign bonds	-	112,113	-	112,113
Real estate/commodities	-	674,598	-	674,598
Other	-	843,530	-	843,530
	<u>\$ 282,310,764</u>	<u>\$ 141,289,414</u>	<u>\$ -</u>	<u>\$ 423,600,178</u>

The amounts reported in the tables above do not include alternative investments totaling \$39,808,077 and \$32,653,014 as of September 30, 2014 and 2013, respectively, that are accounted for under the equity method of accounting.

The above tables do not include \$1,200,000 of land held for sale as of September 30, 2013, which is included within assets limited as to use.

The interest rate swap listed above is classified in the accompanying consolidated balance sheet within other assets at September 30, 2014. The fair value of the interest rate swap is based on the present value of future cash flows based on the mid-market gross value for similar financial instruments.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

Financial assets carried at fair value included in the defined benefit pension plans (see Note 8) are classified in the table below in one of the three categories described above:

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 1,698,734	\$ —	\$ —	\$ 1,698,734
Mutual funds:				
Domestic equity	118,332,328	—	—	118,332,328
International equity	34,869,197	—	—	34,869,197
Fixed income	264,263,351	—	—	264,263,351
Other	3,017,320	—	—	3,017,320
Common collective funds:				
Domestic equity	—	190,589,807	—	190,589,807
International equity	—	51,059,769	—	51,059,769
Other	—	5,012,150	—	5,012,150
Alternative investments	—	—	68,348,654	68,348,654
	<b>\$ 422,180,930</b>	<b>\$ 246,661,726</b>	<b>\$ 68,348,654</b>	<b>\$ 737,191,310</b>

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 10,515,747	\$ —	\$ —	\$ 10,515,747
Mutual funds:				
Domestic equity	23,505,440	—	—	23,505,440
International equity	3,214,773	—	—	3,214,773
Fixed income	116,344,574	—	—	116,344,574
Other	2,906,636	—	—	2,906,636
Common collective funds:				
Domestic equity	—	224,431,869	—	224,431,869
International equity	—	48,250,478	—	48,250,478
Alternative investments	—	—	54,142,557	54,142,557
	<b>\$ 156,487,170</b>	<b>\$ 272,682,347</b>	<b>\$ 54,142,557</b>	<b>\$ 483,312,074</b>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

Fair value for Level 1 assets is based upon quoted market prices. Fair value for Level 2 assets is based upon model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers and brokers. Level 3 assets consist of alternative investments held by the defined benefit plans, the valuation for which is described in Note 1. Many of the investments classified in Levels 2 and 3 in the above tables consist of shares or units in investment funds, as opposed to direct interests in the funds' underlying holdings, which may be marketable. Fair value for alternative investments is determined by the Network's management for each investment using net asset value as a practical expedient, as permitted by generally accepted accounting principles, rather than using another valuation method to independently estimate fair value. The classification of the alternative investments in Level 2 or 3 is based on the Network's ability to redeem its interest at or near the measurement date. If the interest can be redeemed in the near term, the investment is classified in Level 2. The methods described above may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Network believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The changes in the fair value of assets measured using significant unobservable inputs (Level 3) comprised the following:

	September 30	
	2014	2013
Beginning balance at October 1	\$ 54,142,557	\$ 52,676,206
Change in unrealized gains and losses	1,699,966	521,653
Purchases	12,549,131	944,698
Sales	(43,000)	-
Ending balance at September 30	<u>\$ 68,348,654</u>	<u>\$ 54,142,557</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**5. Pledges Receivable**

Pledges receivable include the following unconditional promises to give:

	September 30	
	2014	2013
Due within one year	\$ 16,772,242	\$ 13,857,802
Due within one to five years	21,654,175	28,799,196
Due within greater than five years	508,375	8,375
	<u>38,934,792</u>	<u>42,665,373</u>
Allowance and discount for uncollectible pledges	(1,428,978)	(1,374,204)
Present value of pledges receivable	<u>\$ 37,505,814</u>	<u>\$ 41,291,169</u>

The allowance recognizes the estimated uncollectible portion of pledges and the discount of pledges to net present value. Pledges are discounted using an average rate of 3.13% and 2.00% as of September 30, 2014 and 2013, respectively.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**6. Long-Term Debt and Credit Facility**

Long-term debt consisted of the following:

	September 30	
	2014	2013
Danbury Hospital revenue bonds financed with CHEFA:		
Series H	\$ 39,615,000	\$ 39,615,000
Network revenue bonds financed with CHEFA:		
Series K	26,435,000	28,055,000
Series L	96,000,000	96,000,000
Series M	46,030,000	46,030,000
Series N	38,620,000	39,880,000
Norwalk Hospital revenue bonds financed with CHEFA:		
Series G	22,104,000	—
Series H	7,584,500	—
Series I	8,904,300	—
Series J	84,696,457	—
Norwalk Hospital term and other loans	5,701,296	—
	<u>375,690,553</u>	<u>249,580,000</u>
Less current portion	11,964,141	2,880,000
	<u>\$ 363,726,412</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	\$ 11,964,141
2016	13,008,372
2017	13,153,031
2018	12,516,040
2019	12,570,000
Thereafter	308,520,000
	<u>\$ 371,731,584</u>

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 6. Long-Term Debt and Credit Facility (continued)

The fair value of the revenue bonds, as determined by the Network's investment advisor using a discounted cash flow analysis, was approximately \$385,466,000 and \$250,296,000 at September 30, 2014 and 2013, respectively. The revenue bonds are categorized as Level 2 in the fair value hierarchy described in Note 4. The carrying value of all remaining long-term debt approximates fair value. The Network paid interest of \$10,891,982 and \$7,744,060 in 2014 and 2013, respectively. The Network has capitalized interest of approximately \$5,437,000 and \$3,760,000 in 2014 and 2013, respectively. Debt service funds held under bond indenture agreements for the Danbury Hospital 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 CHEFA Series H revenue bonds (Danbury Series H Bonds) mature from 2030 through 2036 at an average coupon rate of 4.425%. The proceeds of the Danbury 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 Danbury Series H Bonds when due is guaranteed by an insurance policy issued by a commercial insurer.

Under the terms of the Danbury Series H Bonds financing arrangements between Danbury Hospital and the WCHNF (the Obligated Group) and CHEFA, the proceeds of the revenue bonds were loaned to Danbury Hospital. Danbury Hospital is obligated to provide amounts sufficient to pay the principal and interest due on the Danbury 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 and 2013.

In 2011, the Obligated Group was expanded to also include Western Connecticut Health Network, Inc., New Milford Hospital, New Milford Hospital Foundation, Inc. and WCMG. In 2013, New Milford Hospital Foundation, Inc. was dissolved. Additional bonds were issued on behalf of the expanded Obligated Group and all proceeds from the bonds were used to finance Danbury 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 in the schedule above and include:

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 6. Long-Term Debt and Credit Facility (continued)

The CHEFA Series K 2011 revenue bonds (Series K Bonds) were issued in the amount of \$33,035,000. The Series K Bonds bear interest at the 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 CHEFA 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 CHEFA Series L 2011 Revenue Bonds (Series L Bonds) of \$96,000,000 were issued concurrently with Series M 2011 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 the bank purchase rate (1.298% and 1.319% at September 30, 2014 and 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 Danbury Hospital's new patient tower, expansion of a parking garage, capital improvements and to fund capitalized interest.

In 2012, the Network issued the CHEFA Series N revenue bonds (Series N Bonds) in the amount of \$39,880,000 with 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 Danbury Hospital's Series G Bonds.

On December 7, 2012, Norwalk Hospital financed a portion of the construction of an outpatient pavilion and other equipment through the issuance of the CHEFA Series J revenue bonds (Norwalk Series J Bonds), in the original principal amount of \$82,000,000. Interest only payments are required for the first two years of the Norwalk Series J Bonds. Thereafter, monthly payments of principal and interest are required in accordance with the repayment schedule. The Norwalk Series J Bonds are subject to mandatory tender on December 1, 2024. The Norwalk Series J Bonds bear interest at a rate per annum equal to 70% of the sum of the one-month LIBOR Rate plus 300 basis points. The interest rate on the Norwalk Series J Bonds is reset monthly. The repayment of the Norwalk Series J Bonds is secured by the gross receipts pledged by Norwalk Hospital and NHF (collectively, the Norwalk Obligated Group) under the Amended and Restated Master Trust Indenture dated as of December 1, 2012 (the Master Indenture). NHC withdrew as a member of the Norwalk Obligated Group on December 7, 2012.



## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 6. Long-Term Debt and Credit Facility (continued)

On December 7, 2012, the Norwalk Obligated Group entered into an interest rate swap agreement and confirmation with respect to the Norwalk Series J Bonds. The swap confirmation has a notional amount of \$82,000,000. Under the terms of the confirmation, Norwalk Hospital pays a fixed rate of 1.2343% to a counterparty and the counterparty pays a variable rate of 70% of one-month LIBOR to the Norwalk Obligated Group. The payments under the swap confirmation are based on the outstanding notional amount; the notional amount will amortize at the same rate as the Norwalk Series J Bonds. The payments under the swap confirmation effectively produce a synthetic fixed rate of 3.3343% on the Norwalk Series J Bonds through December 1, 2024. The Norwalk Obligated Group entered into the interest rate swap to reduce interest rate volatility on the Series J Bonds.

In 2011, Norwalk Hospital financed the construction of the parking garage and other equipment through a private placement of CHEFA Revenue Bonds, Series G, H and I, in the aggregate principal amount of \$46,840,000. The repayment of the Series G, H and I Bonds is also secured by the Norwalk Obligated Group's pledge of Gross Receipts under the Master Indenture.

The Norwalk Series G Bonds totaling \$25,000,000 mature serially through 2025 with interest at an annual rate of 5.12%. Interest on the bonds is payable semi-annually each June and December 1. As of September 30, 2014, the Norwalk Series G outstanding debt was \$21,380,000.

The Norwalk Series H Bonds totaling \$10,040,000 mature serially through 2020 with interest at an annual rate of 3.49%. Interest on the bonds is payable semi-annually each June and December 1. As of September 30, 2014, the Norwalk Series H outstanding debt was \$7,385,000.

The Norwalk Series I Bonds totaling \$11,800,000 mature serially through 2020 with interest at an annual rate of 3.4%. Interest on the bonds is payable semi-annually each June and December 1. As of September 30, 2014, the Norwalk Series I outstanding debt was \$8,670,000.

In 2011, Norwalk Surgery Center, LLC obtained a \$4,000,000 seven year term loan from The Bank of Fairfield. The loan bears interest at a fixed rate of 4.875%. Monthly payments of interest only are required for the first 18 months of the loan. Thereafter, monthly payments of principal and interest are required based upon a five and one-half year amortization schedule. The loan is secured by a first lien on all business assets of Norwalk Surgery Center, LLC. On March 18, 2014 the loan was paid off in full.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 6. Long-Term Debt and Credit Facility (continued)

On March 18, 2014, Norwalk Surgery Center, LLC obtained a \$3,020,470 four year term loan from Siemens Financial Services. The loan bears interest at a fixed rate of 4.23%. Monthly payments of principal and interest are required based upon a four year amortization schedule. The loan is secured by a first lien on all business assets of Norwalk Surgery Center, LLC. The proceeds of the loan were used to pay off the then outstanding balance of a term loan with the Bank of Fairfield. As of September 30, 2014, the outstanding debt related to the Norwalk Surgery Center, LLC term loan was \$2,670,216.

In 2007, Norwalk Hospital financed certain equipment related to an energy project through CHEFA, which issued \$9,066,025 in debt under a Master Financing Agreement (the Agreement), dated as of April 1, 2007 with Bank of America Public Capital Corp. as the lender (the Lender). The loan is payable in 120 equal installments of \$93,432 beginning June 3, 2007, with interest of 4.38%. Norwalk Hospital has granted a collateral interest to the Lender in the equipment financed. As of September 30, 2014, the CHEFA outstanding debt was \$2,898,294.

In connection with this borrowing, Norwalk Hospital applied to the Department of Public Utility Control (DPUC) for a capital grant for customer-side distributed resources. Pursuant to the application, DPUC has approved a rate reduction subsidy with regard to certain of the equipment financed under this Agreement. Effective July 3, 2010, the rate reduction subsidy of \$1,302 per month is remitted by the Connecticut Light and Power Company directly to the Lender and is recorded as a reduction to interest expense.

In 2007, Norwalk Hospital entered into an agreement with the Connecticut Hospital Association Trust (the "Trust") to borrow up to \$2,000,000 from the energy conservation and loan management loan fund. The loan, which is interest free, will enable Norwalk Hospital to convert electrical energy and to manage its electrical energy needs. The loan is payable in 84 equal monthly installments of \$22,462, beginning April 1, 2008. As of September 30, 2014, the Trust's outstanding debt was \$132,786.

In connection with the acquisition of NHSC described in Note 1, Norwalk Hospital's long-term debt was adjusted to fair value and the existing unamortized bond discount was written off. The fair value adjustment included a decrease in the carrying value of \$724,000, \$199,500, \$234,300, \$2,696,458, and \$104,713 related to the Norwalk Series G Bond, Norwalk Series H Bond, Norwalk Series I Bond, Norwalk Series J Bond and the Norwalk Hospital CHEFA loan, respectively, that will be amortized as interest expense using the effective interest method over the remaining life of the bonds. Approximately \$1,255,873 of unamortized bond issuance costs was written off.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 7. Commitments and Contingencies

##### Litigation

Malpractice claims have been asserted against the Network by various claimants. The claims are in various stages of processing and some may ultimately be brought to trial. In addition, the Network 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 Network's financial position.

##### Workers' Compensation Insurance

The Network is self-insured for workers' compensation benefits. Liabilities of approximately \$8,926,000 and \$6,932,000, using a discount rate of 3.00-5.60% and 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 accrued pension liabilities and other on the consolidated balance sheets.

##### Operating Leases

The Network has entered into several lease agreements for 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 \$22,916,305 and \$15,882,198 for the years ended September 30, 2014 and 2013, respectively. Rent is included in supplies and other expense on the consolidated statements of operations and changes in net assets.

The future minimum lease payments for the years ending September 30 are as follows:

2015	\$ 21,538,245
2016	20,382,108
2017	19,126,053
2018	17,902,626
2019	15,973,910
Thereafter	70,677,609
	<u>\$ 165,600,551</u>

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 8. Pension Plans

The Network has three defined benefit pension plans, for which plan benefits are based on years of service and the employee's compensation (collectively referred to as the Plans). Effective May 26, 2011, the Board of Directors adopted a resolution to freeze the Network's retirement plan (the Network Plan) for non-union employees effective December 31, 2011 with certain employees continuing to accrue benefits based on age and vesting. Effective September 7, 2012, the Board of Directors adopted a second resolution to freeze benefits for all of those that had been continuing to accrue.

The New Milford Hospital retirement plan (the New Milford Plan) was frozen effective January 31, 2010 and was amended effective October 31, 2012 to cease the future accrual of benefits to each highly compensated employee as defined by the IRS.

Effective September 30, 2013, the Norwalk Hospital retirement plan (the Norwalk Hospital Plan) was frozen for all purposes (except as provided below) for those Participants who are not covered by the collective bargaining agreement between Norwalk Hospital and the Connecticut Health Care Associates, National Union of Hospital and Health Care Employees, AFSCME, AFL-CIO Nurses' Union ("Non-Union Participants"). This means that no Non-Union Participants shall accrue benefits under the plan after September 30, 2013 and no compensation or service after that date shall be taken into account in determining such participants' accrued benefits under the plan, provided, however, that interest credits shall continue to be credited as required by applicable law. Norwalk Hospital Plan Participants who are members of the Connecticut Health Care Associates, National Union of Hospital and Health Care Employees, AFSCME, AFL-CIO Nurses' Union, and who were employed by the Norwalk Hospital on or before December 31, 2006 (when the Norwalk Hospital Plan was frozen for all new hires), shall continue to accrue benefits under the Norwalk Hospital Plan.

Effective December 31, 2006, the Norwalk Hospital Plan was amended to provide that no employees hired on or after January 1, 2007, would be eligible to participate in the Norwalk Hospital Plan. Employees hired before that date, who satisfied the Norwalk Hospital Plan's eligibility requirements, participated and earned benefits under the plan until it was frozen as described above.

Contributions to the Plans are intended to provide for benefits attributed to services rendered to date. The Network makes contributions in amounts sufficient to meet the required benefits to be paid to the Plans' participants as they become due as required by the Employee Retirement Income Security Act of 1974.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 8. Pension Plans (continued)

The Network established defined contribution pension plans for all eligible employees after freezing the Plans. Pension expense related to the defined contribution plans for the years ended September 30, 2014 and 2013 was \$19,052,471 and \$15,124,977, respectively.

The Network also maintains noncontributory, supplemental defined-benefit retirement plans (Supplemental Plans) for certain executive employees. As of September 30, 2014 and 2013, the projected benefit obligation for the Supplemental Plans amounted to \$14,033,199 and \$3,690,461, respectively, which was included in accrued pension liabilities and other in the accompanying consolidated balance sheets. The expenses incurred related to the Supplemental Plans amounted to \$2,616,625 and \$1,664,854 for the years ended September 30, 2014 and 2013, respectively. Effective October 1, 2009, the New Milford Hospital Supplemental Plan was frozen. Provisions have been made to "grandfather" those participants in the plan that are sixty years old and have at least ten years of service.

Included in unrestricted net assets at September 30, 2014 and 2013, are the following amounts that have not yet been recognized in net periodic pension cost: Unrecognized actuarial loss pertaining to the Plans of \$225,970,137 and \$115,514,412, respectively. The actuarial loss included in unrestricted net assets at September 30, 2014 and expected to be recognized in net periodic pension gain during the year ending September 30, 2015 is \$5,040,836.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**8. Pension Plans (continued)**

The following table presents a reconciliation of the beginning and ending balances of the Plans' projected benefit obligation and the fair value of plan assets, as well as the funded status of the Plans and accrued pension cost included in the consolidated balance sheets:

	September 30	
	2014	2013
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	\$ (529,483,820)	\$ (592,567,972)
Inclusion of benefit obligation at acquisition of Norwalk Hospital Association	(187,980,011)	-
Service cost	(1,418,928)	(2,167,994)
Assumption changes	(7,749,946)	8,434,543
Amendment	-	127,811
Interest cost	(34,594,065)	(24,676,967)
Benefits paid	24,007,811	14,949,311
Actuarial (loss) gain	(109,110,893)	66,417,448
Benefit obligation at end of year	<u>(846,329,852)</u>	<u>(529,483,820)</u>
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	483,312,074	430,517,695
Inclusion of plan assets at acquisition of Norwalk Hospital Association	194,441,064	-
Contributions	30,053,868	26,107,867
Expenses	(159,480)	(124,244)
Actual return on plan assets	53,551,595	41,760,067
Benefits paid	(24,007,811)	(14,949,311)
Fair value of plan assets at end of year	<u>737,191,310</u>	<u>483,312,074</u>
Underfunded status of the Plans	<u>\$ (109,138,542)</u>	<u>\$ (46,171,746)</u>
	<b>Year Ended September 30</b>	
	2014	2013
<b>Components of net periodic benefit income</b>		
Service cost	\$ 1,418,928	\$ 2,167,994
Interest cost	34,594,065	24,676,967
Expected return on plan assets	(49,753,177)	(34,763,778)
Net amortization and deferral	1,575,718	3,678,608
Recognized net loss	1,190,458	2,089,996
Prior service cost	-	42,682
Net periodic benefit income	<u>\$ (10,974,008)</u>	<u>\$ (2,107,531)</u>

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 8. Pension Plans (continued)

The actuarial loss in 2014 primarily relates to changes in the discount rate and mortality table used to measure the benefit obligation, and the actuarial gain in 2013 primarily relates to changes in the discount rate used to measure the benefit obligation.

The assumptions used to develop net periodic benefit income and the projected benefit obligation for the Plans are as follows:

	September 30	
	2014	2013
Discount rate used for net periodic benefit income	5.23-5.29%	4.12-4.23%
Discount rate used for projected benefit obligation	4.56-4.64%	5.23-5.25%
Expected long-term rate of return on plan assets	7.50-8.00%	8.00%
Average rate of increase in compensation	3.00-3.50%	3.00%

To develop the expected long-term rate of return on plan assets assumption, the Network considered the historical return and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

The accumulated benefit obligation for the Plans at September 30, 2014 and 2013 was \$839,972,808 and \$529,077,179, respectively.

#### Plan Assets

The Plans' 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 Plans aim to minimize the variability in yearly returns. The Plans also aim to diversify holdings among sectors, industries, and companies. The target allocations for the Network Plan assets are 40% in equities, 35% in fixed income securities and 25% in alternative investments. The assets of the New Milford Hospital Plan are all held in mutual funds, whereas the assets of the Norwalk Hospital Plan are 64% in equities and 36% in debt securities.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**8. Pension Plans (continued)**

The weighted average asset allocations for the Plans' assets by category are as follows:

<u>Asset Category</u>	<u>September 30</u>	
	<u>2014</u>	<u>2013</u>
Equity securities	54%	64%
Debt securities	36	24
Other investments	10	12
	<u>100%</u>	<u>100%</u>

As discussed in Note 4, the Network follows a three-level hierarchy to categorize assets measured at fair value. In accordance with this hierarchy, as of September 30, 2014 and September 30, 2013, 58%, 33% and 9%, and 33%, 56% and 11%, respectively, of the Plans' assets which are measured at fair value on a recurring basis were categorized as Level 1, Level 2 and Level 3 investments, respectively.

**Contributions**

The Network expects to contribute \$32,155,000 to its Plans in fiscal year 2015.

**Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

<u>Fiscal Year</u>	<u>Pension Benefits</u>
2015	\$ 30,574,208
2016	32,758,889
2017	34,940,773
2018	37,337,370
2019	39,923,275
Years 2020 – 2024	231,850,425



## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 9. Professional Liability Insurance

Effective October 1, 2004, the Network formed a captive insurance company, WCHNIC, domiciled in the Cayman Islands, to provide alternative professional liability insurance to the Hospital, New Milford Hospital, as of October 1, 2010, and WCMG, as well as providing community doctors with a competitive professional liability insurance option.

From October 1, 2005 through February 28, 2014, Norwalk Hospital was insured for general liability and professional liability claims by MSI on a claims-made basis. MSI, previously structured as a wholly owned subsidiary of NHSC, was a captive insurance company incorporated under the laws of the Bermuda Monetary Authority. Effective March, 2014, MSI merged with WCHNIC. All claims prior to March 1, 2014 that were previously insured by MSI were assumed by WCHNIC through a loss portfolio transfer and risk was transferred.

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 Network has recorded a liability of \$14,003,000 and \$10,661,668 at September 30, 2014 and 2013, respectively, based on a discount rate of 3.5% as of September 30, 2014 and 2013, for incurred-but-not-reported claims, which is included in accrued pension liabilities and other on the accompanying consolidated balance sheets.

Assets held by WCHNIC approximate \$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.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Professional Liability Insurance (continued)**

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 the beginning of period	\$ 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 NHSC acquisition	 <u>31,430,158</u>	 —
Net provision for losses and loss adjustment expenses	<u>\$ 81,991,423</u>	<u>\$ 46,294,520</u>

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

The above table does not include \$3,924,927 of net provision for losses and loss adjustment expense for commercial reinsurance held by Norwalk Hospital.

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.

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 10. Net Assets

Temporarily restricted net assets of \$92,944,545 and \$62,336,151 as of September 30, 2014 and 2013, respectively, are available to the Network for health care services and capital expenditures and include the Network's beneficial interest in charitable remainder trust. Permanently restricted net assets total \$43,258,322 and \$33,382,843 as of September 30, 2014 and 2013, respectively, and represent investments to be held in perpetuity and beneficial interest in trusts held by others, the income from which is expendable to support health care services.

#### 11. Endowments

The Network endowment consists of approximately 58 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, are classified and reported in the accompanying consolidated balance sheets based on the existence or absence of donor-imposed restrictions.

The Leadership of the Network has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Network classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time of the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Network considers the following factors in making a determination to appropriate or accumulate donor-restricted funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the Network and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Network
- (7) The investment policies of the Network

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**11. Endowments (continued)**

The Network has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Network 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, the Network relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Network targets a diversified asset allocation to achieve its long-term objective within prudent risk constraints. For WCHNF, each year, the Network's 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 WCHNF 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 Network Board abides by these regulations and will adjust this rate accordingly.

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	\$ -	\$ 17,332,894	\$ 35,500,625	\$ 52,833,519
Board-designated endowment funds	9,785,387	-	-	9,785,387
Endowment net assets at end of year	<u>\$ 9,785,387</u>	<u>\$ 17,332,894</u>	<u>\$ 35,500,625</u>	<u>\$ 62,618,906</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Endowments (continued)

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	\$ 15,272,503	\$ 25,789,216	\$ 50,176,223
Acquisition of NHSC	-	3,596,737	9,461,652	13,058,389
Investment return:				
Investment income, net	170,178	901,373	-	1,071,551
Change in unrealized gains and losses	500,705	2,355,620	-	2,856,325
Total investment return	670,883	3,256,993	-	3,927,876
Contributions	-	353,083	131,085	484,168
Net asset transfers and appropriations	-	(5,027,750)	-	(5,027,750)
Other changes:				
Transfers to permanently restricted endowment	-	(118,672)	118,672	-
Endowment net assets at end of year	<u>\$ 9,785,387</u>	<u>\$ 17,332,894</u>	<u>\$ 35,500,625</u>	<u>\$ 62,618,906</u>

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 15,272,503	\$ 25,789,216	\$ 41,061,719
Board-designated endowment funds	9,114,504	-	-	9,114,504
Endowment net assets at end of year	<u>\$ 9,114,504</u>	<u>\$ 15,272,503</u>	<u>\$ 25,789,216</u>	<u>\$ 50,176,223</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**11. Endowments (continued)**

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at beginning of the year	\$ 8,357,137	\$ 13,820,607	\$ 25,696,661	\$ 47,874,405
Investment return:				
Investment income, net	658,488	2,955,473	-	3,613,961
Change in unrealized gains and losses	98,879	409,999	-	508,878
Total investment return	757,367	3,365,472	-	4,122,839
Contributions	-	299,260	167,410	466,670
Net asset reclassification- net change in loss on endowments	-	(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>\$ 15,272,503</u>	<u>\$ 25,789,216</u>	<u>\$ 50,176,223</u>

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 the Network to retain as a fund of perpetual duration. These deficiencies result from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Directors. There was no deficiencies of this nature which are reported in unrestricted net assets for the years ended September 30, 2014 and 2013.

Also included within permanently restricted net assets are \$7,757,697 and \$7,593,627 of beneficial interests in trusts held by others as of September 30, 2014 and 2013, respectively.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**12. Changes in Components of Operating Assets and Liabilities**

	Year Ended September 30	
	2014	2013
(Increase) decrease in operating assets:		
Pledges receivable	\$ 10,006,392	\$ (29,478,711)
Accounts receivable, net	(63,673,439)	(21,312,717)
Inventories	(333,287)	98,980
Prepaid expenses and other assets	6,688,839	(96,003)
	<u>(47,311,495)</u>	<u>(50,788,451)</u>
Increase (decrease) in operating liabilities:		
Accounts payable	(2,094,038)	7,213,169
Payroll-related accruals	6,113,481	11,040,069
Due to third-party payors	6,475,769	(1,693,878)
Interest payable	509,148	82,294
Other accrued expenses	241,539	(450,606)
Self-insurance liabilities	(12,667,985)	4,063,268
Accrued pension liabilities and other	(35,071,128)	(24,647,657)
	<u>(36,493,214)</u>	<u>(4,393,341)</u>
Decrease in operating assets and liabilities	<u>\$ (83,804,709)</u>	<u>\$ (55,181,792)</u>

**13. Other Operating Revenue**

Other operating revenue consisted of the following:

	Year Ended September 30	
	2014	2013
Rental income	\$ 4,341,923	\$ 1,235,625
Grants	5,202,891	3,580,696
Captive malpractice insurance premiums	2,896,179	1,658,846
Captive investment income	1,272,580	1,177,798
Education	1,642,376	1,602,413
Research	540,851	307,830
EHR incentive payments	3,187,219	2,948,348
Dietary/nutrition	1,539,779	293,864
Ancillary services	913,172	—
Other income	3,562,846	558,725
	<u>\$ 25,099,816</u>	<u>\$ 13,364,145</u>

## Western Connecticut Health Network, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 14. Functional Expenses

The Network provides general health care services to residents within its geographic location. Expenses related to providing these services, including the operating expenses of the Western Connecticut Health Network Foundation, Inc. and the Norwalk Hospital Foundation, Inc. are as follows:

	Year Ended September 30	
	2014	2013
Healthcare services	\$ 727,950,128	\$ 563,182,659
General and administrative	230,038,422	123,839,606
Fundraising	3,520,010	2,818,144
	<u>\$ 961,508,560</u>	<u>\$ 689,840,409</u>

#### 15. Subsequent Events

Subsequent events have been evaluated through February 27, 2015, which represents the date the consolidated financial statements were issued.

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

On October 1, 2014, NHSC merged into Western Connecticut Health Network, Inc. At that time, the Network became the sole corporate member of Norwalk Hospital, SWC Corporation and Norwalk Health Care, Inc. As a result of this transaction, Norwalk Hospital became the sole corporate member of NHF and NHP&S, which were previously structured as subsidiaries of NHSC.

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



## Supplementary Information



Western Connecticut Health Network, Inc. and Subsidiaries  
Consolidating Statement of Operations  
Year Ended September 30, 2014

	The Danbury Hospital and Subsidiary	Western Connecticut Health Network, Inc.	Western Connecticut Health Network, Inc.	The New Milford Hospital, Inc.	Western Connecticut Medical Group P.C.C.	Emulation	Oldage Group	Norwalk Hospital Association	Norwalk Hospital System, Inc.	Norwalk Hospital Foundation, Inc.	SNC Corporation	Western Connecticut Health Network Affiliates, Inc.	Total Other Network/Affiliates	Emulation	Total
Unrestricted revenue:															
Net patient service revenue	\$ 321,477,663	\$ -	\$ -	\$ 63,850,140	\$ 107,783,831	\$ (286,068)	\$ 692,825,566	\$ 269,437,864	\$ 12,218,814	\$ -	\$ 7,693,575	\$ 13,441,678	\$ 6,972,871	\$ (499,448)	\$ 1,002,037,230
Provision for uncollectible accounts	16,984,907	-	-	2,043,381	1,624,472	(286,068)	20,622,755	21,801,052	518,730	-	6,234	448,515	301,365	-	43,788,341
Net patient service revenue less provision for uncollectible accounts	304,492,756	-	-	61,806,759	106,159,359	-	672,172,811	247,636,812	11,679,684	-	7,687,341	12,993,163	6,671,506	(499,448)	958,248,889
Net assets released from restriction	5,665,862	-	-	18,850	116,659	-	5,800,981	866,277	294,509	-	-	107,548	193,917	-	7,155,684
Other operating revenue	252,923,700	-	-	799,545	987,244	-	63,169,742	(70,079,826)	20,441,105	-	2,893,960	1,073,884	1,033,772	(11,629,487)	2,222,216
	535,772,318	-	-	799,545	62,813,533	-	169,445,375	(70,365,894)	698,414,897	-	10,581,311	13,100,647	7,804,215	(22,197,131)	990,544,979
Expenses:															
Salaries, benefits and fees	300,891,797	-	-	2,035,673	37,998,243	141,727,873	(60,615,008)	422,028,978	126,906,378	19,280,667	3,506,702	6,946,424	4,361,263	-	931,423,822
Supplies and other	136,187,262	-	-	1,206,188	151,292,807	22,125,248	(3,449,533)	193,196,770	92,376,571	8,397,237	6,492,463	4,371,629	2,521,432	(15,700,969)	204,213,121
Insurance	21,991,696	-	-	2,692	2,097,747	4,866,841	(6,161,469)	21,397,676	3,971,539	1,072,841	69,836	388,234	301,700	(6,317,180)	20,861,003
Depreciation and amortization	31,684,167	-	-	9,215	3,477,844	8,962,828	(38,693,479)	14,499,173	1,499,173	115,632	-	697,104	66,224	-	53,445,138
Interest	4,557,028	-	-	-	-	298	-	88,130,336	239,533,324	-	-	-	-	-	6,326,466
Operating income (loss)	514,909,230	-	-	3,124,128	64,835,801	168,272,288	(70,127,546)	481,320,386	239,533,324	-	10,129,001	12,705,221	7,248,800	(21,912,922)	927,888,550
Income tax expense	20,872,288	-	-	(2,964,583)	(2,012,259)	671,712	6,332	17,033,311	20,685,047	(6,167,639)	224,308	395,626	668,414	(211,139)	32,555,929
	-	-	-	-	-	-	-	-	-	-	(84,440)	-	-	-	(106,501)
Nonoperating gain (losses):															
Combinatorial	-	788,042	-	-	-	-	-	788,042	-	(161,828)	-	-	4,574,121	-	5,171,373
Investment income, net	3,546,237	932,592	-	20,637	(99,423)	(202,501)	4,237,542	928,804	-	(738)	-	1,967	669,390	-	5,772,865
Change in unrestricted gains and losses on investments	11,234,037	1,470,546	-	-	-	-	12,724,483	2,156,725	-	-	-	-	995,087	-	15,876,384
Contribution received in the acquisition of NHSC	-	-	-	-	298,901,287	-	298,901,287	-	-	-	-	-	-	-	296,901,287
Change in equity interest in unrestricted net assets of the Western Connecticut Health Network Foundation, Inc. and Norwalk Hospital Foundation, Inc.	(40,571)	-	-	(6,796)	-	47,367	-	3,123,337	-	(1,267,299)	-	1,967	-	-	(1,265,332)
Interest rate swap activity:															
Interest cost on interest rate swap	-	-	-	-	-	-	-	-	(161,828)	-	-	-	-	-	(161,828)
Change in value of interest rate swap	-	-	-	-	-	-	-	-	(2,302,627)	-	-	-	-	-	(2,302,627)
Operating expense of the Western Connecticut Health Network Foundation, Inc. & Norwalk Hospital Foundation, Inc.	-	(2,423,113)	-	-	-	-	91,134	(2,333,981)	-	(2,664,435)	-	-	-	-	(4,292,400)
Excess (deficiency) of revenues over expenses, before nonoperating interest in joint venture	14,799,703	766,044	-	(6,796)	(93,423)	(63,980)	312,177,472	3,542,431	-	(1,267,299)	-	1,967	1,739,687	(3,044,687)	317,883,554
Less: Net income attributable to nonoperating interests in joint venture	35,632,091	766,044	-	(2,019,154)	612,289	(37,628)	329,320,938	24,227,478	(6,167,639)	3,306,084	149,868	397,393	2,344,600	(2,275,226)	350,333,982
Excess (deficiency) of revenues over expenses	\$ 33,637,091	\$ 766,044	\$ -	\$ (2,019,154)	\$ 612,289	\$ (37,628)	\$ 329,320,938	\$ 221,108,770	\$ (6,167,639)	\$ 3,306,084	\$ 149,868	\$ 397,393	\$ 2,344,600	\$ (2,275,226)	\$ 349,216,374

\* Excludes Eastern View - York Medical Services, P.C.

Western Connecticut Health Network, Inc. and Subsidiaries  
Consolidating Balance Sheet  
September 30, 2013

	The Danbury Hospital and Subsidiary	Western Connecticut Health Network, Inc.	Western Connecticut Health Network, Inc.	The Hospital, Inc.	Western Connecticut Group, P.C.*	Eliminations	Obligated Group	Western Connecticut Affiliates, Inc.	Other Network Affiliates	Eliminations	Total
<b>Assets:</b>											
Cash and cash equivalents	\$ 59,531,409	\$ 2,472,437	\$ 383,079	\$ 2,221,385	\$ 6,910,101	\$ -	\$ 69,239,611	\$ 887,421	\$ 1,596,475	\$ -	\$ 71,777,627
Current portion of assets limited as to use	4,899,827	1,300,000	-	-	-	-	-	-	-	-	6,200,827
Accounts receivable	57,504,970	13,627,769	-	7,314,799	7,779,034	-	13,627,769	2,719,093	1,057,099	-	76,374,995
Accounts receivable, less allowance for uncollectible accounts of \$20,597,000	7,022,219	-	-	-	946,306	-	72,998,803	-	-	-	76,744,995
Current portion of due from related parties	5,251,295	-	-	-	1,521,171	-	1,128,278	-	30,311	-	11,838,609
Prepaid expenses and other	13,284,841	27,999	17,142	1,521,171	183,112	-	1,228,278	103,188	-	-	13,800,802
Total current assets	152,058,999	15,100,405	460,225	11,428,830	16,888,601	(7,304,620)	188,179,232	3,708,698	2,282,526	(552,433)	194,341,603
Investments	199,169,615	11,634,105	-	-	-	-	210,803,720	-	-	-	210,803,720
Assets limited as to use:											
Funds restricted by donor	-	47,433,280	-	-	-	-	47,433,280	-	-	-	47,433,280
Board designated funds	-	9,422,297	-	-	-	-	9,422,297	-	-	-	9,422,297
Beneficial interest in trust held by others	-	7,293,627	-	-	-	-	7,293,627	-	-	-	7,293,627
Construction loans	45,694,876	-	-	-	-	-	45,694,876	-	-	-	45,694,876
Construction loans - Western Connecticut Health Network Insurance Co. Ltd	28,410,010	-	-	-	-	-	28,410,010	-	-	-	28,410,010
Total investment assets limited as to use	194,103,986	64,449,204	-	-	-	-	188,535,690	-	-	-	188,535,690
Total investment assets	195,539	220,732	9,044,971	4,652,903	5,000,636	(2,299,139)	16,815,682	-	-	-	16,815,682
Other assets	106,193,031	-	-	11,319,493	-	(117,912,524)	-	-	-	-	16,815,682
Interest in Western Connecticut Health Network Foundation, Inc.	5,739,847	-	1,059,937	-	541,992	(724,776)	-	-	-	-	5,999,524
Due from related parties	9,964,032	471,934	-	1,461,567	7,124,295	-	11,897,212	3,188,699	3,835	-	32,295,460
Property, plant, and equipment	222,804,495	211,311	40,134	43,953,291	6,623,782	-	239,478,466	9,057,130	78,676	-	283,646,029
Buildings and improvements	103,866,676	1,389,231	74,940	4,537,992	480,886	-	110,888,534	69,031	-	-	110,954,885
Leasehold improvements	671,888,505	1,389,231	74,940	97,737,223	14,440,603	-	745,530,452	12,312,260	780,511	-	758,623,223
Equipment and other	521,857,286	1,420,317	64,851	63,808,519	6,000,915	-	598,573,280	9,248,660	(713,982)	-	606,828,025
Construction in progress (estimated cost to complete at September 30, 2013: \$71,035,600)	-	-	5,939	20,806,784	8,517,148	-	26,653,707	2,771,274	66,529	-	29,595,192
Less accumulated depreciation	5,999,525	27,663,400	-	-	-	-	27,663,400	-	-	-	27,663,400
Pledge receivable, less current portion	-	-	-	-	-	-	5,999,525	-	-	-	5,999,525
Due to insurance com., net	878,182,488	120,101,203	10,544,030	61,269,930	30,862,577	(13,438,667)	964,060,321	6,880,292	3,786,503	(352,433)	973,173,660
Total assets	\$ 878,182,488	\$ 120,101,203	\$ 10,544,030	\$ 61,269,930	\$ 30,862,577	\$ (13,438,667)	\$ 964,060,321	\$ 6,880,292	\$ 3,786,503	\$ (352,433)	\$ 973,173,660
<b>Liabilities and net assets:</b>											
Current liabilities:											
Accounts payable	\$ 33,744,172	\$ -	\$ 500	\$ 2,548,429	\$ (992,057)	\$ (182,428)	\$ 35,115,616	\$ 344,129	\$ 96,393	\$ -	\$ 35,566,138
Deferred revenue	28,585,512	79,791	-	2,911,133	13,429,989	-	44,288,562	407,213	149,013	-	44,842,215
Prepaid expenses	8,170,030	661,676	211,248	6,514,297	216,274	(7,432,948)	10,688,702	240,400	31,680	(92,433)	11,856,129
Current portion of due to related parties	1,706,774	148,723	808,711	358,515	329,657	-	4,570,763	(443,453)	6,240	-	4,131,560
Interest payable	2,889,000	890,190	-	1,032,459	13,783,340	(7,615,310)	292,242,291	548,309	678,033	(352,433)	2,891,880
Current portion of long-term debt and capital lease obligations	46,380,935	(380)	-	13,282,674	5,431,345	(2,167,401)	46,380,935	2,687	449,392	-	46,380,935
Due to related parties	18,062,437	-	452,738	2,476,284	4,511,893	(7,400,915)	79,598,629	-	-	-	79,598,629
Self-insurance liabilities	246,790,000	889,610	46,403,331	29,542,298	22,746,451	(17,323,693)	41,328,252	548,296	1,127,425	(52,433)	246,790,000
Accrued pension liability and other	386,502,537	-	-	-	-	-	-	-	-	-	386,502,537
Total liabilities	400,930,008	23,628,047	(35,839,211)	23,332,942	8,126,126	(21,522,982)	396,627,220	5,931,296	1,921,680	-	404,480,146
Net assets:											
Unrestricted	486,647,111	119,211,528	(35,839,211)	4,122,215	8,126,126	(68,228,930)	402,218,266	5,931,296	2,409,028	-	623,851,151
Temporarily restricted	29,131,525	62,828,703	-	1,272,632	31,227,632	-	93,218,266	-	-	-	114,580,455
Permanently restricted	878,182,488	120,101,203	10,544,030	61,269,930	30,862,577	(13,438,667)	964,060,321	6,880,292	3,786,503	(352,433)	973,173,660
Total net assets	\$ 878,182,488	\$ 120,101,203	\$ 10,544,030	\$ 61,269,930	\$ 30,862,577	\$ (13,438,667)	\$ 964,060,321	\$ 6,880,292	\$ 3,786,503	\$ (352,433)	\$ 973,173,660

\* Includes Eastern New York Medical Services, P.C.

Western Connecticut Health Network, Inc. and Subsidiaries  
Consolidating Statement of Operations  
Year Ended September 30, 2013

	The Danbury Hospital and Subsidiary	Western Connecticut Health Network Foundation, Inc.	Western Connecticut Health Network, Inc.	The New Milford Hospital, Inc.	Western Connecticut Medical Group, P.C.*	Eliminations	Obligated Group	Western Connecticut Health Network Ambiles, Inc.	Other Network Ambiles	Eliminations	Total
Unrestricted revenue:											
Net medical services revenue	\$ 518,977,309	\$ -	\$ -	\$ 72,281,954	\$ 106,571,423	\$ (283,090)	\$ 697,603,591	\$ 13,567,360	\$ 4,903,482	\$ (969,448)	\$ 715,654,985
Provision for uncollectible accounts	19,104,609	-	(5,315)	2,889,657	1,851,338	-	23,869,469	1,226,641	122,641	-	24,322,854
Net patient service revenue less provision for uncollectible accounts	499,872,700	-	5,315	69,422,297	104,866,064	(283,090)	673,884,122	5,332,199	4,780,841	(969,448)	691,222,131
Net assets released from restriction	5,221,901	-	-	130,298	-	-	-	-	161,856	-	5,384,055
Other operating revenue	18,529,750	-	407,786	744,102	60,438,633	(66,797,990)	13,320,281	139,679	123,366	(219,061)	13,864,145
	\$23,624,791	-	413,501	70,296,697	165,302,697	(67,081,084)	692,256,602	13,206,295	506,594	(728,599)	710,100,331
Expenses:											
Salaries, benefits and fees	298,231,765	-	1,128,349	44,019,423	139,625,769	(38,061,937)	424,963,309	7,281,838	3,363,433	-	435,698,640
Supplies and other	147,192,020	-	1,966,692	20,871,060	20,983,020	(2,848,912)	188,166,790	4,745,902	2,026,534	(602,918)	194,316,128
Insurance	15,709,626	-	2,065,741	2,065,741	3,256,611	(5,378,611)	15,709,626	93,564	12,027	(125,591)	15,709,626
Depreciation and amortization	30,033,313	-	1,180	5,443,180	1,183,674	-	36,663,247	623,242	14,351	-	37,304,840
Interest	3,984,131	-	263,572	263,572	36,551	(217,223)	4,067,031	-	-	-	4,067,031
Operating income (loss)	495,170,755	-	3,302,390	72,662,276	165,087,625	(66,653,683)	669,570,653	12,744,546	5,436,165	(728,599)	687,022,265
Income tax (expense) credit	28,444,036	-	(750)	(2,366,279)	213,072	(427,401)	22,398,539	461,749	(370,222)	-	23,078,066
Nonoperating gains (losses):											
Contributions	-	628,817	-	-	-	-	-	-	-	-	628,817
Investment income, net	4,782,118	2,462,438	(137,892)	-	2,769	(273,481)	7,015,892	2,711	35,848	-	7,034,037
Change in unrealized gains and losses on investments	5,199,125	346,222	-	-	-	-	5,545,347	-	50,880	-	5,596,197
Change in equity interests in unrestricted net assets of the Western Connecticut Health Network Foundation, Inc.	206,244	-	-	282,759	-	(489,003)	-	-	-	-	-
Operating expenses of the Western Connecticut Health Network Foundation, Inc.	-	(2,900,123)	-	-	-	91,008	(2,818,144)	3,711	111,300	-	(2,818,144)
Expense (deficiency) of revenues over expenses	10,872,487	708,325	(137,892)	282,759	3,769	(627,420)	10,271,912	3,711	111,300	-	10,485,982
	\$38,641,233	\$ 708,325	\$ (137,892)	\$ (2,083,520)	\$ 217,781	\$ (1,098,877)	\$ 13,257,701	\$ 464,460	\$ (99,560)	\$ -	\$ 33,222,595

\* Includes Eastern New York Medical Services, P.C.

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