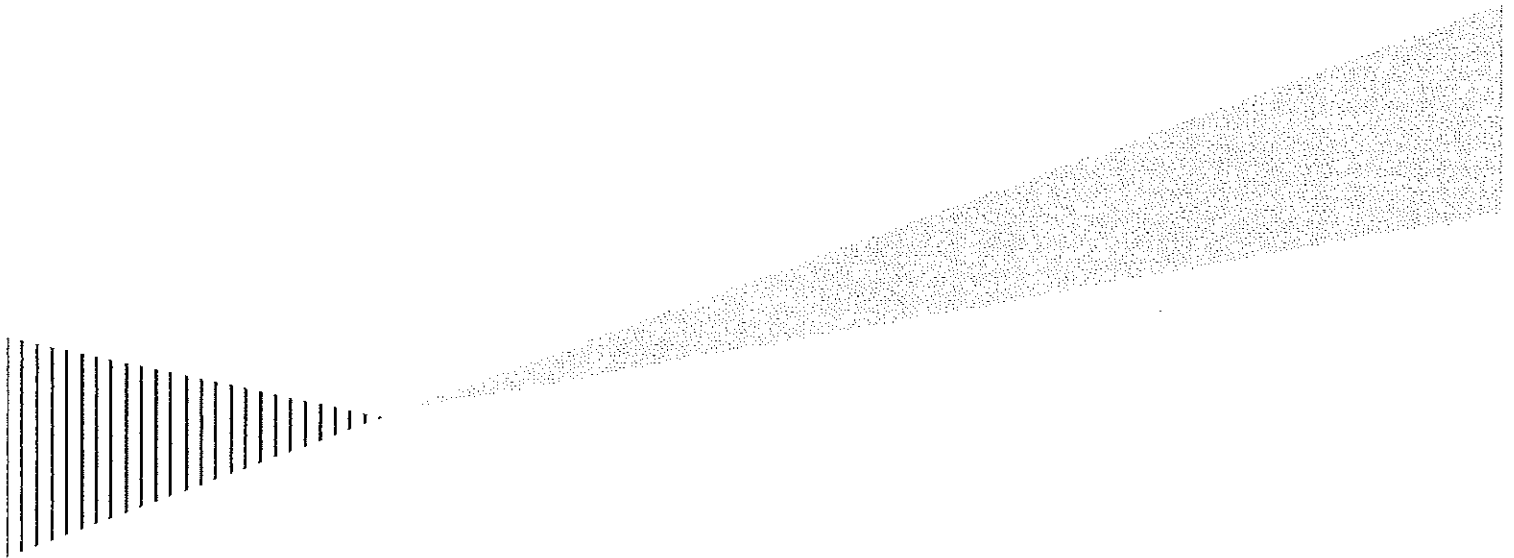


CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Western Connecticut Health Network, Inc. and Subsidiaries
Years Ended September 30, 2015 and 2014
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Western Connecticut Health Network, Inc. and Subsidiaries

Consolidated Financial Statements
and Supplementary Information

Years Ended September 30, 2015 and 2014

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Report of Independent Auditors

The Board of Directors
Western Connecticut Health Network, Inc.

We have audited the accompanying consolidated financial statements of Western Connecticut Health Network, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of September 30, 2015 and 2014, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Western Connecticut Health Network Insurance Co., Ltd. (the Company), a wholly-owned subsidiary, which statements reflect total assets constituting 8% as of September 30, 2015 and 2014, and total revenues constituting 2% in 2015 and 2014, of the consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for 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.

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, 2015 and 2014, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating balance sheet and statement of operations are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the 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

January 28, 2016

Western Connecticut Health Network, Inc. and Subsidiaries

Consolidated Balance Sheets
(In Thousands)

	September 30	
	2015	2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 89,299	\$ 144,315
Investments, current portion	13,983	14,004
Assets limited as to use, current portion	7,368	9,864
Pledges receivable, current portion	41,268	16,375
Patient accounts receivable, less allowance for uncollectible accounts of approximately \$42,590 in 2015 and \$43,007 in 2014	143,408	128,633
Inventories	14,880	14,459
Prepaid expenses and other	23,102	30,763
Total current assets	<u>333,308</u>	<u>358,413</u>
Investments	301,033	335,991
Assets limited as to use:		
Funds restricted by donor	87,103	83,512
Board designated funds	36,934	10,116
Beneficial interests in trusts held by others and charitable remainder trust	14,563	15,766
Construction funds	8,743	23,405
Investments held by Western Connecticut Health Network Insurance Co., Ltd.	115,882	97,160
Total noncurrent assets limited as to use	<u>263,225</u>	<u>229,959</u>
Other assets	23,791	28,094
Property, plant, and equipment:		
Land and land improvements	40,722	40,541
Buildings and building improvements	745,603	692,524
Equipment and other	611,444	585,356
Construction-in-progress (estimated cost to complete at September 30, 2015: \$31,883)	106,873	108,749
	<u>1,504,642</u>	<u>1,427,170</u>
Less accumulated depreciation	<u>824,711</u>	<u>775,230</u>
	679,931	651,940
Pledges receivable, less current portion	6,592	21,130
Bond issuance costs, net	4,062	4,611
Total assets	<u>\$ 1,611,942</u>	<u>\$ 1,630,138</u>

	September 30	
	2015	2014
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 63,644	\$ 71,620
Payroll-related accruals	69,290	69,089
Due to third-party payors	46,275	53,636
Interest payable	2,494	2,574
Other accrued expenses	3,817	4,373
Current portion of long-term debt	9,227	11,964
Total current liabilities	<u>194,747</u>	<u>213,256</u>
Self-insurance liabilities	78,958	86,032
Accrued pension liabilities and other	227,988	169,570
Long-term debt, less current portion	354,959	363,726
Total liabilities	<u>856,652</u>	<u>832,584</u>
Net assets:		
Unrestricted	601,286	659,346
Unrestricted attributable to noncontrolling interest	2,035	2,005
Temporarily restricted	107,926	92,945
Permanently restricted	44,043	43,258
Total net assets	<u>755,290</u>	<u>797,554</u>

Total liabilities and net assets

\$ 1,611,942 \$ 1,630,138

See accompanying notes.

Western Connecticut Health Network, Inc. and Subsidiaries

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

	Year Ended September 30	
	2015	2014
Unrestricted revenues:		
Net patient service revenue	\$ 1,162,464	\$ 1,032,103
Provision for uncollectible accounts	38,642	43,748
Net patient service revenue, less provision for uncollectible accounts	1,123,822	988,355
Net assets released from restriction	8,093	7,156
Other operating revenues	25,524	25,100
	<u>1,157,439</u>	<u>1,020,611</u>
Expenses:		
Salaries, benefits and fees	684,755	590,468
Supplies and other	334,175	286,888
Insurance	9,517	20,861
Depreciation and amortization	68,744	53,445
Interest	9,510	6,327
State of Connecticut Hospital Tax	39,046	30,066
	<u>1,145,747</u>	<u>988,055</u>
Income from operations before net gain on extinguishment of long-term debt	11,692	32,556
Net gain on extinguishment of long-term debt	1,268	—
Income from operations	<u>12,960</u>	<u>32,556</u>
Income tax expense	168	107
Nonoperating gains and (losses):		
Contributions	33,105	5,518
Investment income, net	9,298	5,773
Change in unrealized gains and losses on investments	(14,249)	15,876
Contribution received in the acquisition of Norwalk Health Services Corporation and Subsidiaries	—	296,901
Operating expenses of the Western Connecticut Health Network Foundation, Inc. and Norwalk Hospital Foundation, Inc.	(4,312)	(3,520)
Interest rate swap activity:		
Interest cost on interest rate swap	(356)	(162)
Change in value of interest rate swap	(2,928)	(2,502)
	<u>(3,284)</u>	<u>(2,664)</u>
	<u>20,558</u>	<u>317,884</u>
Excess of revenues over expenses, before noncontrolling interest in joint venture	33,350	350,333
Less: net income attributable to noncontrolling interest in joint venture	(1,968)	(1,117)
Excess of revenues over expenses	<u>31,382</u>	<u>349,216</u>

Western Connecticut Health Network, Inc. and Subsidiaries

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

	Year Ended September 30	
	2015	2014
Unrestricted net assets:		
Excess of revenues over expenses (continued)	\$ 31,382	\$ 349,216
Net assets released from restrictions for property, plant and equipment	5,815	19,844
Transfer from (to) temporarily and permanent restricted net assets	147	(564)
Change in pension obligation	(94,525)	(111,967)
Net unrestricted other changes in joint venture	(1,874)	(599)
Net income attributable to noncontrolling interest in joint venture	1,968	1,117
Other	(943)	(176)
(Decrease) increase in unrestricted net assets	(58,030)	256,871
Temporarily restricted net assets:		
Contributions	30,107	12,291
Investment income, net	1,372	1,714
Change in unrealized gains and losses on investments	(3,068)	3,124
Contribution received in the acquisition of Norwalk Health Services Corporation and Subsidiaries	—	39,887
Change in beneficial interest in charitable remainder trust	(452)	425
Net assets released from restriction	(8,093)	(7,156)
Net assets released from restrictions for property, plant and equipment	(5,815)	(19,844)
Transfer (to) from unrestricted and permanently restricted net assets	(147)	445
Other	1,077	(278)
Increase in temporarily restricted net assets	14,981	30,608
Permanently restricted net assets:		
Change in beneficial interest in trusts held by others	(751)	164
Contributions	1,536	131
Contribution received in the acquisition of Norwalk Health Services Corporation and Subsidiaries	—	9,462
Transfer from unrestricted and temporarily restricted net assets	—	119
Increase in permanently restricted net assets	785	9,876
(Decrease) increase in net assets	(42,264)	297,355
Net assets at beginning of year	797,554	500,199
Net assets at end of year	\$ 755,290	\$ 797,554

See accompanying notes.

Western Connecticut Health Network, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended September 30	
	2015	2014
Operating activities		
(Decrease) increase in net assets	\$ (42,264)	\$ 297,355
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	68,744	53,445
Change in unrealized gains and losses on investments	17,317	(19,000)
Change in pension obligation	94,525	111,967
Other changes in net assets	(134)	455
Restricted contributions and investment income	(33,015)	(14,136)
Net gain on extinguishment of long-term debt	(1,268)	-
Change in beneficial interest in trusts held by others and charitable remainder trust	1,203	(589)
Provision for uncollectible accounts	38,642	43,748
Contribution received in the acquisition of Norwalk Health Services Corporation	-	(346,250)
Changes in operating assets and liabilities (see Note 12)	(110,633)	(83,316)
Net cash provided by operating activities	<u>33,117</u>	<u>43,679</u>
Investing activities		
Additions to property, plant, and equipment, net	(96,735)	(142,531)
Cash received from the acquisition of Norwalk Health Services Corporation and Subsidiaries	-	83,043
Purchases and sales of investments, net	(14,177)	78,436
Net cash (used in) provided by investing activities	<u>(110,912)</u>	<u>18,948</u>
Financing activities		
Proceeds from issuance of bonds	122,120	3,021
Payments of long-term debt	(132,356)	(7,247)
Restricted contributions and investment income	33,015	14,136
Net cash provided by financing activities	<u>22,779</u>	<u>9,910</u>
Net (decrease) increase in cash and cash equivalents	(55,016)	72,537
Cash and cash equivalents at beginning of year	144,315	71,778
Cash and cash equivalents at end of year	<u>\$ 89,299</u>	<u>\$ 144,315</u>

See accompanying notes.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars in Thousands)

September 30, 2015

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, Inc. (WCMG); Eastern New York Medical Services, P.C. (ENYMS); Norwalk Health Services Corporation (NHSC); The Norwalk Hospital Association (Norwalk Hospital); Norwalk Hospital Foundation (NHF); Norwalk Hospital Physicians and Surgeons (NHP&S); Norwalk Health Care, Inc. (NHC); SWC Corporation (SWC); and Maple Street Indemnity Company, Ltd (MSIC).

Danbury Hospital

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).

On October 1, 2014 (the merger date), Danbury Hospital received a single provider license to include New Milford Hospital. As a result, New Milford Hospital merged with Danbury Hospital and the operations of New Milford Hospital became a department of Danbury Hospital effective October 1, 2014. Danbury Hospital will operate as one licensed facility with two campuses. Prior to the merger date, New Milford Hospital was a voluntary, not-for-profit, non-stock corporation incorporated under the General Statutes of the State of Connecticut and was a member of the Network. There was no impact to the consolidated financial statements of the Network.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Norwalk Health Services Corporation Affiliation

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 and its majority interest in the Norwalk Surgery Center, LLC; NHP&S; NHC; NHF; SWC and MSI. The Network acquired NHSC by means of an inherent contribution where no consideration was transferred by the Network. 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. Subsequent to the Transaction Date, MSIC, 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.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

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.

	January 1, 2014
Assets	
Cash and cash equivalents	\$ 83,043
Short-term investments	33,670
Current portion of pledges receivable	1,765
Accounts receivable, net of allowance for uncollectible accounts	32,333
Inventories	2,867
Prepaid expenses and other	3,649
Investments	135,777
Funds restricted by donor	35,545
Beneficial interest in charitable remainder trust	7,583
Construction funds	50,869
Other assets	29,995
Property, plant and equipment, net	213,060
Pledges receivable, less current portion	4,456
Total assets acquired	<u>634,612</u>
Liabilities	
Accounts payable	38,158
Payroll-related accruals	18,133
Due to third-party payors	36,362
Interest payable	358
Current portion of long-term debt and capital lease obligations	5,347
Self-insurance liabilities	52,319
Accrued pension liabilities and other	12,695
Long-term debt and capital lease obligation, less current portion	124,990
Total liabilities assumed	<u>288,362</u>
Excess of assets acquired over liabilities assumed	<u>\$ 346,250</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Net assets acquired	
Unrestricted	\$ 296,901
Temporarily restricted	39,887
Permanently restricted	9,462
	<u>\$ 346,250</u>

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.

	<u>Period From January 1, 2014 to September 30, 2014</u>
Excess of revenues over expenses	<u>\$ 19,084</u>
Change in net assets:	
Unrestricted net assets	\$ (22,952)
Temporarily restricted net assets	(7,525)
Permanently restricted net assets	—
Total change in net assets	<u>\$ (30,477)</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

The following table represents unaudited pro forma financial information for the Network, assuming the affiliation with NHSC had taken place on October 1, 2013. 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, 2013.

	Year Ended September 30, 2014
Excess of revenues over expenses	\$ 69,992
Change in net assets:	
Unrestricted net assets	\$ (5,654)
Temporarily restricted net assets	(7,234)
Permanently restricted net assets	420
Total change in net assets	\$ 12,468

Norwalk Hospital, a voluntary, not-for-profit organization incorporated under the General Statutes of the State of Connecticut, was a wholly owned subsidiary of NHSC through October 1, 2014. On October 1, 2014, NHSC merged into the Network. At that time, the Network became the sole corporate member of Norwalk Hospital. As a result of this transaction, two subsidiaries of NHSC, NHF and NHP&S, were merged into Norwalk Hospital (collectively referred to as Norwalk Hospital), as of October 1, 2014. Effective September 30, 2015, NHP&S was dissolved and all remaining assets were transferred to NHA on that date.

NHP&S is a not-for-profit organization established under the General Statutes of the State of Connecticut and provides physician services to patients primarily in the Greater Norwalk area. NHP&S also provides physician support to Norwalk Hospital. NHF is a 501(c)(3) organization whose tax-exempt status is based upon its support of the Network and the health care providers affiliated with it, including Norwalk Hospital and other health care organizations from time to time associated with the Network which qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code. The Board of NHA is appointed by the Network.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Other Affiliates

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.

WCHNF is a 501(c)(3) organization whose tax-exempt status is based upon its support of the Network and the health care providers affiliated with it, including Danbury Hospital and other health care organizations from time to time associated with the Network which qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code.

Principles of Consolidation

The consolidated financial statements include the accounts of the Network, Danbury Hospital, WCHNF, WCHNA, BSI, WCHC, WCMG, ENYMS, Norwalk Hospital, NHC and SWC. 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 consolidated financial statements and accompanying footnotes. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates. Significant estimates reflected in the consolidated financial statements include the contractual allowances and allowance for uncollectible accounts for patient service revenue and the related patient accounts receivable, estimated revenue settlements due to or from third parties, reserves for malpractice, workers' compensation and other self-insured liabilities, and benefit plan assumptions.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

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. The carrying value of cash equivalents approximates its fair value. Cash and cash equivalents are maintained with domestic financial institutions with deposits that exceed federally insured limits. It is the 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. 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.

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

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

investments held by the defined benefit pension plans are reported at fair value as estimated in an unquoted market using net asset value as a practical expedient. 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.

Fair Value of Financial Instruments

The carrying values of financial instruments classified as current assets and current liabilities as of September 30, 2015 and 2014, approximate fair value based on current market conditions. The fair values of other financial instruments are disclosed in the respective notes and/or in Note 4. Investments include certificates of deposit with original maturities in excess of three months.

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 property, plant and equipment; assets held by trustees under bond 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.

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.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

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.

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.

Inventories

The Network uses the first in, first out method, in the valuation of inventory.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost, or if received as a donation, at the fair value on the date received. Property, plant, and equipment for NHSC and subsidiaries that were purchased subsequent to the Transaction Date are stated at cost, less accumulated depreciation. Property, plant and equipment existing at the Transaction Date were recorded at fair value based upon an independent valuation. 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 1–55 years.

Bond Issuance Costs

Discounts and deferred costs related to the issuance of bonds are amortized over the period the obligation is outstanding, using a method that approximates the effective interest method. Accumulated amortization of discounts and deferred costs were \$1,177 and \$1,322 at September 30, 2015 and 2014, respectively. During 2015, the Network wrote off \$1,357 of bond issuance costs and paid \$1,082 in additional bond issuance costs in conjunction with a refinancing (see Note 6).

Excess of Revenues Over Expenses

The accompanying 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 obligations, net income attributable to noncontrolling interest in joint venture, and net unrestricted other changes in joint venture.

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

Other Operating Revenues

Other operating revenues consists primarily of the net premiums and interest income of WCHNIC, grant income, education income, research income, cafeteria revenues, EHR incentive payments, and rental income of the Network (see Note 14).

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Nonoperating Gains and (Losses)

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

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 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.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Income Taxes

The Network comprises not-for-profit corporations, with the exception of BSI, WCHNIC and SWC, 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 and SWC 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. Norwalk Surgery Center, LLC is a limited liability corporation and is treated as a partnership for income tax purposes.

The Network has net operating loss carryforwards from unrelated business activities of approximately \$52,126 and \$50,382 at September 30, 2015 and 2014, respectively, which will begin expiring in 2018. These losses generate a potential deferred tax asset of approximately \$20,850 and \$20,153 at September 30, 2015 and 2014, respectively, which is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future periods. SWC has a capital loss carryforward of approximately \$2,480 at September 30, 2015 and 2014. A deferred tax asset for these losses of approximately \$992 at September 30, 2015 and 2014, is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future years. For SWC, the tax provision and any subsequent liability is not material to the consolidated financial statements.

Asset Retirement Obligation

The Network records a liability for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation is conditional on a future event. The fair value of a liability for a conditional asset retirement obligation is recognized in the period in which the obligation is incurred if a reasonable estimate of fair value can be made. As of September 30, 2015 and 2014, \$9,446 and \$9,412, respectively, is included in accrued pension liabilities and other, relating to such obligations. There are no assets that are legally restricted for purposes of settling asset retirement obligations. During 2015 and 2014, retirement obligations incurred and settled were minimal.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

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 \$1,671 and \$3,187 of EHR revenues during its fiscal year ended September 30, 2015 and 2014, respectively, comprised of \$14 and \$371 of Medicaid revenues and \$1,657 and \$2,816 of Medicare revenues in 2015 and 2014, respectively. EHR revenues are included in other operating revenues in the accompanying consolidated statements of operations and changes in net assets.

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.

State of Connecticut Hospital Tax

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

Reclassifications

Certain reclassifications have been made to the year ended September 30, 2014, balances previously reported in the consolidated balance sheets and consolidated statements of operations and changes in net assets and cash flows in order to conform with the year ended September 30, 2015, presentation. State of Connecticut Hospital Tax in the amount of \$30,066 was reclassified from net patient service revenue to an operating expense. In addition, physician fees in the amount of \$7,325 were reclassified from supplies and other expense to salaries, benefits, and fees expense.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

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, as amended by ASU 2015-14, is required on October 1, 2018, and management is currently evaluating the effect of this guidance on its consolidated financial statements.

2. Net Patient Service Revenue and Charity Care

The 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, reviews and investigations.

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. Additionally, certain payors' payment rates for various years have been appealed by the Network. If the appeals are successful, additional income applicable to those years might be realized.

Approximately 32%, 9% and 59%, and 32%, 8% and 60% of net patient service revenue was received from Medicare, Medicaid and non-governmental payors, respectively for the year ended September 30, 2015 and 2014, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

Western Connecticut Health Network, Inc. and Subsidiaries

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

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

The Network believes it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Network. Cost reports for the Network, which serves as the basis for the final settlement with government payors, have been settled by final settlement through 2012 for Medicare and 1994 and 1996 for Norwalk Hospital and Danbury Hospital, respectively, for Medicaid. Other years remain open for settlement.

During 2015 and 2014, the Network recorded an increase in net patient service revenue of approximately \$16,852 and \$783, respectively, related to changes in previously estimated third-party payor settlements.

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 30%, 11% and 59% and 37%, 13% and 50% for Medicare, Medicaid and non-governmental payors, respectively, at September 30, 2015 and 2014, respectively.

The following table summarizes net patient service revenue:

	Year Ended September 30	
	2015	2014
Gross patient service revenue	\$ 2,865,780	\$ 2,462,702
Deductions:		
Allowances	1,669,573	1,403,078
Charity care (at charges)	33,743	27,521
	<u>1,703,316</u>	<u>1,430,599</u>
Net patient service revenue	1,162,464	1,032,103
Provision for uncollectible accounts	<u>38,642</u>	<u>43,748</u>
Net patient service revenue less provision for uncollectible accounts	<u>\$ 1,123,822</u>	<u>\$ 988,355</u>

Western Connecticut Health Network, Inc. and Subsidiaries

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

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

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	
	2015	2014
Third-party payors	\$ 1,115,226	\$ 991,645
Self-pay patients	47,238	40,458
	<u>\$ 1,162,464</u>	<u>\$ 1,032,103</u>

The Network accepts all patients regardless of their ability to pay. A patient is classified as a charity care patient by reference to established policies of the 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. Those charges are not included in net patient service revenue for financial reporting purposes.

The estimated cost of charity care provided was approximately \$13,160 and \$10,503 for the years ended September 30, 2015 and 2014, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by Network-specific data.

3. Investments and Assets Limited as to Use

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

	September 30	
	2015	2014
Cash and cash equivalents	\$ 74,795	\$ 90,666
Common collective funds	109,845	112,364
Fixed income securities	384	16,123
Mutual funds	336,561	310,049
Real estate/commodities	564	1,851
Alternative investments (at equity method)	47,697	42,999
	<u>\$ 569,846</u>	<u>\$ 574,052</u>

Western Connecticut Health Network, Inc. and Subsidiaries

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

3. Investments and Assets Limited as to Use (continued)

The above tables do not include \$1,200 of land held for sale as of September 30, 2015 and 2014, which is included within assets limited as to use. Also included in assets limited as to use is beneficial interest in trusts held by others and charitable remainder trusts of \$14,563 and \$15,766 as of September 30, 2015 and 2014, respectively.

Investment income included in nonoperating gains and (losses) for the years ended September 30, 2015 and 2014, consists of:

	<u>2015</u>	<u>2014</u>
Interest and dividend income	\$ 7,500	\$ 4,729
Realized gains and losses, net and equity income on alternative investments	1,798	1,044
	<u>\$ 9,298</u>	<u>\$ 5,773</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.

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.

Western Connecticut Health Network, Inc. and Subsidiaries

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

4. Fair Values of Financial Instruments (continued)

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)

(Dollars in Thousands)

4. Fair Values of Financial Instruments (continued)

Financial instruments 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, 2015			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 89,299	\$ --	\$ --	\$ 89,299
Investments and assets limited as to use:				
Cash and cash equivalents	74,795	--	--	74,795
Mutual funds:				
Domestic equity	80,641	--	--	80,641
International equity	31,034	--	--	31,034
Fixed income	224,886	--	--	224,886
Common collective funds:				
Domestic equity	--	85,232	--	85,232
International equity	--	24,613	--	24,613
Securities:				
Fixed income	--	384	--	384
Real estate/commodities	82	482	--	564
Beneficial interest in trusts held by others and charitable remainder trust:				
Cash and cash equivalents	683	--	--	683
Mutual funds:				
Domestic equity	3,528	--	--	3,528
International equity	2,720	--	--	2,720
Fixed income	2,460	--	--	2,460
Common collective funds:				
Domestic equity	--	1,807	--	1,807
International equity	--	617	--	617
Fixed income	--	357	--	357
Corporate and foreign bonds	--	111	--	111
Real estate/commodities	--	684	--	684
Other	835	761	--	1,596
	510,963	115,048	--	626,011
Liabilities:				
Interest rate swap	--	(418)	--	(418)
	\$ 510,963	\$ 114,630	\$ --	\$ 625,593

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Fair Values of Financial Instruments (continued)

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 144,315	\$ —	\$ —	\$ 144,315
Investments and assets limited as to use:				
Cash and cash equivalents	90,666	—	—	90,666
Mutual funds:				
Fixed income	310,049	—	—	310,049
Common collective funds:				
Domestic equity	494	86,115	—	86,609
International equity	63	25,692	—	25,755
Securities:				
Fixed income	8,515	7,608	—	16,123
Real estate/commodities	93	1,758	—	1,851
Beneficial interest in trusts held by others and charitable remainder trust:				
Cash and cash equivalents	856	—	—	856
Mutual funds:				
Domestic equity	3,144	—	—	3,144
International equity	2,997	—	—	2,997
Fixed income	2,400	—	—	2,400
Common collective funds:				
Domestic equity	—	2,058	—	2,058
International equity	—	771	—	771
Fixed income	—	362	—	362
Corporate and foreign bonds	—	113	—	113
Real estate/commodities	—	1,048	—	1,048
Other	1,053	964	—	2,017
Other assets:				
Interest rate swap	—	2,510	—	2,510
	<u>\$ 564,645</u>	<u>\$ 128,999</u>	<u>\$ —</u>	<u>\$ 693,644</u>

The amounts reported in the tables above do not include alternative investments totaling \$47,697 and \$42,999 as of September 30, 2015 and 2014, respectively, that are accounted for under the equity method of accounting. The above tables do not include \$1,200 of land held for sale as of September 30, 2015 and 2014, which is included within assets limited as to use. The Network has unfunded commitments to alternative investments of approximately \$37,757 as of September 30, 2015.

Western Connecticut Health Network, Inc. and Subsidiaries

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

4. Fair Values of Financial Instruments (continued)

The interest rate swap listed above is classified in the accompanying consolidated balance sheets within accrued pension liabilities and other and other assets at September 30, 2015 and 2014, respectively. 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.

Financial assets carried at fair value included in the defined benefit pension plans (see Note 7) are classified in the table below in one of the three categories described above:

	September 30, 2015			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 6,149	\$ --	\$ --	\$ 6,149
Mutual funds:				
Domestic equity	100,333	--	--	100,333
International equity	35,968	--	--	35,968
Fixed income	256,941	--	--	256,941
Other	2,901	--	--	2,901
Common collective funds:				
Domestic equity	--	189,276	--	189,276
International equity	--	52,307	--	52,307
Alternative investments	--	--	88,935	88,935
Other	--	148	--	148
	<u>\$ 402,292</u>	<u>\$ 241,731</u>	<u>\$ 88,935</u>	<u>\$ 732,958</u>

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 1,699	\$ --	\$ --	\$ 1,699
Mutual funds:				
Domestic equity	118,332	--	--	118,332
International equity	34,869	--	--	34,869
Fixed income	264,264	--	--	264,264
Other	3,017	--	--	3,017
Common collective funds:				
Domestic equity	--	190,590	--	190,590
International equity	--	51,060	--	51,060
Alternative investments	--	--	73,361	73,361
	<u>\$ 422,181</u>	<u>\$ 241,650</u>	<u>\$ 73,361</u>	<u>\$ 737,192</u>

Western Connecticut Health Network, Inc. and Subsidiaries

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

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	
	2015	2014
Beginning balance at October 1	\$ 73,361	\$ 54,143
Purchases	22,041	17,549
Sales	(8,269)	(43)
Change in unrealized gains and losses	1,802	1,712
Ending balance at September 30	<u>\$ 88,935</u>	<u>\$ 73,361</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

5. Pledges Receivable

Pledges receivable include the following unconditional promises to give:

	September 30	
	2015	2014
Due within one year	\$ 41,903	\$ 16,772
Due within one to five years	6,598	21,654
Due within greater than five years	400	508
	<u>48,901</u>	<u>38,934</u>
Allowance and discount for uncollectible pledges	(1,041)	(1,429)
Present value of pledges receivable	<u>\$ 47,860</u>	<u>\$ 37,505</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 2.06% and 3.13% as of September 30, 2015 and 2014, respectively.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

6. Long-Term Debt and Credit Facility

Long-term debt consisted of the following:

	September 30	
	2015	2014
Network revenue bonds financed with CHEFA:		
Series G	\$ 20,704	\$ —
Series H (Danbury Hospital)	39,615	39,615
Series H (Norwalk Hospital)	6,602	—
Series I	7,751	—
Series J	80,230	—
Series K	—	26,435
Series L	—	96,000
Series M	46,030	46,030
Series N	37,085	38,620
Series O	122,120	—
Norwalk Hospital revenue bonds financed with CHEFA:		
Series G	—	22,104
Series H	—	7,585
Series I	—	8,904
Series J	—	84,696
Norwalk Hospital term and other loans	4,049	5,701
	<u>364,186</u>	<u>375,690</u>
Less current portion	9,227	11,964
	<u>\$ 354,959</u>	<u>\$ 363,726</u>

The following is a summary of the combined aggregate amount of maturities and sinking fund requirements of the aforementioned obligations at September 30, 2015, according to their long-term amortization schedule and excluding the unamortized fair value adjustment recorded at the Transaction Date:

2016	\$ 9,227
2017	9,226
2018	8,296
2019	8,180
2020	8,500
Thereafter	319,670
	<u>\$ 363,099</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

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

The fair value of the revenue bonds, as determined by the Network's financing consultant using a discounted cash flow analysis, was approximately \$373,117 and \$385,466 at September 30, 2015 and 2014, respectively. The revenue bonds are categorized as Level 2 in the fair value hierarchy described in Note 4.

The Network paid interest of \$11,494 and \$10,892 in 2015 and 2014, respectively. The Network has capitalized interest of approximately \$1,664 and \$5,437 in 2015 and 2014, respectively. Debt service funds held under bond indenture agreements for the Danbury Hospital Series H Bonds and Series N Bonds were \$1,868 and \$1,869 at September 30, 2015 and 2014, respectively.

The Network holds eight series of bonds. In 2011, the Obligated Group, previously comprised of Danbury Hospital and WCHNF, was expanded to include the Network, New Milford Hospital and WCMG. During May 2015, Norwalk Hospital and NHF were added to the Obligated Group. All proceeds from the bonds were used to finance Network capital projects. As a result, all of the Norwalk Hospital revenue bonds are reflected as Network revenue bonds in the scheduled above for the year ended September 30, 2015. 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 CHEFA Series H revenue bonds (Danbury Hospital Series H Bonds) mature from 2030 through 2036 at an average coupon rate of 4.425%. The proceeds of the Danbury Hospital 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 payments of principal and interest on the Danbury Hospital Series H Bonds when due is guaranteed by an insurance policy issued by a commercial insurer.

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

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

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. The Series K Bonds bore interest at the bank purchase rate (1.390% at September 30, 2014) and matured serially from September 30, 2011 to September 30, 2036. In 2015, the Series K Bonds were refunded in conjunction with the issuance of the Series O revenue bonds (Series O Bonds).

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

In 2015, the Network issued Series O Bonds in the amount of \$122,120, which bear interest at a variable rate tied to LIBOR (0.979% at September 30, 2015). The Series O Bonds mature serially from July 1, 2022 to July 1, 2041. The proceeds of the Series O Bonds were used to refund the Network Series K and Series L Bonds, which were fully redeemed as of September 30, 2015. The Network recorded a loss on the extinguishment of long-term debt of \$1,357 in the consolidated statements of operations in 2015.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

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

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 (Series J Bonds), in the original principal amount of \$82,000. Interest-only payments were required for the first two years of the Series J Bonds. In May 2015, Norwalk Hospital amended the loan agreement associated with the Series J Bonds (with principal then outstanding of \$80,935), primarily to reduce the interest rate and amend certain financial covenants. The amended loan terms qualified as an extinguishment of the debt under applicable accounting requirements. The Network recorded a gain on the extinguishment of long-term debt of \$2,625 in the consolidated statements of operations in 2015. The Series J Bonds are subject to mandatory tender on December 1, 2024, and bear interest at a rate per annum equal to 70% of the sum of the one-month LIBOR Rate plus 125 basis points. The interest rate on the Series J Bonds is reset monthly.

On December 7, 2012, Norwalk Hospital entered into an interest rate swap agreement to reduce the interest rate volatility on the Series J Bonds. The swap confirmation has a notional amount of \$82,000. Under the terms of the agreement, Norwalk Hospital pays a fixed rate of 1.2343% to the counterparty, and the counterparty pays a variable rate of 70% of one-month LIBOR to Norwalk Hospital. 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 Hospital Series J Bonds. The payments under the swap confirmation produce a synthetic fixed rate of 2.1093% on the Series J Bonds through December 1, 2024.

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. As of May 8, 2015, the repayment of the Series G, H and I Bonds are secured by the Gross Receipts pledged by the Obligated Group under the Network Master Trust Indenture. As a result, the Network is obligated to provide amounts sufficient to pay the principal and interest due on the Series G, H, and I Bonds.

The Series G Bonds totaling \$25,000 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.

The Series H Bonds totaling \$10,040 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.

Western Connecticut Health Network, Inc. and Subsidiaries

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

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

The Series I Bonds totaling \$11,800 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.

In 2007, Norwalk Hospital financed certain equipment related to an energy project through CHEFA, which issued \$9,066 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 beginning June 3, 2007, with interest of 4.38%. Norwalk Hospital has granted a collateral interest to the Lender in the equipment financed.

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 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 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 beginning April 1, 2008. The loan was paid in full in fiscal year 2015.

In connection with the acquisition of NHSC described in Note 1, Norwalk Hospital's long-term debt was adjusted to fair value at the Transaction Date and the existing unamortized bond discount was written off. The fair value adjustment included a decrease in the carrying value of \$724, \$200, \$234, \$2,696, and \$105 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 is being amortized as interest expense using the effective-interest method over the remaining life of the bonds. Approximately \$1,256 of unamortized bond issuance costs was written off in connection with the refinancing in May 2015.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. 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, 2015, the New Milford Hospital pension plan merged into the Network's plan. As a result, the benefit obligation and plan assets were transferred to the Network as of that date. There was no impact to the consolidated financial statements of the Network.

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.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Pension Plans (continued)

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.

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, 2015 and 2014, was \$24,769 and \$19,052, respectively.

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	
	2015	2014
Change in benefit obligation		
Benefit obligation at beginning of year	\$ (846,330)	\$ (529,484)
Inclusion of benefit obligation at acquisition of Norwalk Hospital Association	-	(187,980)
Service cost	(2,161)	(1,419)
Assumption changes	(25,076)	(7,750)
Interest cost	(38,399)	(34,594)
Benefits paid	28,459	24,008
Actuarial loss	(11,173)	(109,111)
Benefit obligation at end of year	<u>(894,680)</u>	<u>(846,330)</u>
Change in plan assets		
Fair value of plan assets at beginning of year	737,192	483,312
Inclusion of plan assets at acquisition of Norwalk Hospital Association	-	194,441
Employer contributions	32,262	30,054
Expenses	-	(159)
Actual return on plan assets	(8,037)	53,552
Benefits paid	(28,459)	(24,008)
Fair value of plan assets at end of year	<u>732,958</u>	<u>737,192</u>
Unfunded status, included in accrued pension liabilities and other on the accompanying consolidated balance sheets	<u>\$ (161,722)</u>	<u>\$ (109,138)</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Pension Plans (continued)

	Year Ended September 30	
	2015	2014
Components of net periodic benefit income		
Service cost	\$ 2,161	\$ 1,419
Interest cost	38,399	34,594
Expected return on plan assets	(55,379)	(49,753)
Net amortization and deferral	4,303	1,576
Recognized net loss	1,818	1,190
Net periodic benefit income	<u>\$ (8,698)</u>	<u>\$ (10,974)</u>

The actuarial loss in 2015 and 2014 primarily relates to changes in the discount rate and mortality table used to measure the benefit obligation.

Assumptions

	2015	2014
Weighted-average assumptions used to determine benefit obligations		
Discount rate	4.43–4.49%	4.56–4.64%
Rate of increase in compensation	3.00–3.50%	3.00–3.50%
Weighted-average assumptions used to determine net periodic benefit income		
Discount rate	4.56–4.64%	5.23–5.29%
Rate of increase in compensation	3.50%	3.00–3.50%
Expected long-term return on plan assets	7.50%	7.50–8.00%

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

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Pension Plans (continued)

Amounts recorded in unrestricted net assets and not yet amortized as components of net periodic benefit cost total \$319,514 and \$225,970 as of September 30, 2015 and 2014, respectively, and represent unrecognized actuarial losses. The amortization of these components expected to be recognized in net periodic benefit for the year ended September 30, 2016, is \$2,329.

The accumulated benefit obligation was \$888,217 and \$839,973 for the years ended September 30, 2015 and 2014, respectively. The Plans' measurement date is September 30.

Plan Assets

The Network maintains target allocation percentages among various asset classes based on an investment policy established for the Plans which is designed to achieve long-term objectives of return, while mitigating against downside risk and considering expected cash flows. The target allocations for the Network Plans' assets are 50% in equities, 25% in fixed income securities and 25% in alternative investments. The investment policy is reviewed from time to time to ensure consistency with the long-term objective of funding the Plans to a level sufficient to pay benefits as they become due.

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

Asset Category	September 30	
	2015	2014
Equity securities	52%	54%
Debt securities	35	36
Other investments	13	10
	<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, 2015 and 2014, 55%, 34%, and 11%, and 58%, 33%, and 9%, 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.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Pension Plans (continued)

Contributions

The Network expects to contribute \$31,000 to its Plans in fiscal year 2016.

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>
2016	\$ 31,740
2017	34,340
2018	37,030
2019	39,890
2020	42,410
Years 2021–2025	246,380

8. Professional Liability Insurance

Effective October 1, 2004, the Network formed a captive insurance company, WCHNIC, domiciled in the Cayman Islands, to provide alternative general and professional liability insurance to the Hospital, WCMG, and Norwalk Hospital, as of March 1, 2014, 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 MSIC on a claims-made basis. MSIC, previously structured as a wholly owned subsidiary of NHSC, was a captive insurance company incorporated under the laws of the Bermuda Monetary Authority.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. Professional Liability Insurance (continued)

Effective March 1, 2014, MSIC merged with WCHNIC. All claims prior to March 1, 2014, that were previously insured by MSIC were assumed by WCHNIC through a loss portfolio transfer, and all risk was transferred. Norwalk Hospital had professional liability coverage through MSIC of \$35,000 per claim and \$48,000 in the aggregate. MSIC purchased \$30,000 of excess reinsurance coverage above a self-insured retention of \$5,000 per claim and \$18,000 in the aggregate.

Coverage for medical malpractice insurance with WCHNIC is on a claims-made basis. The Network has professional liability coverage through WCHNIC of \$45,000 per claim and \$70,000 in the aggregate. WCHNIC purchased \$40,000 of excess reinsurance coverage above a self-insured retention of \$5,000 per claim and \$30,000 in the aggregate. The Network has recorded a liability of \$12,819 and \$14,003 at September 30, 2015 and 2014, respectively, based on a discount rate of 3.5% (as of September 30, 2015 and 2014), for incurred-but-not-reported claims, which is included in accrued pension liabilities and other on the accompanying consolidated balance sheets.

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

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. 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, 2015 and 2014 is summarized as follows:

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

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

The above table does not include \$3,925 of net provision for losses and loss adjustment expense for commercial reinsurance held by Norwalk Hospital, for the year ended September 30, 2014.

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, 2015 and 2014; however, no assurance can be given that the ultimate settlement of losses may not vary materially from the liability recorded. Future adjustments to the amounts recorded resulting from the continual review process, as well as differences between estimates and ultimate payments, will be reflected in the consolidated statements of operations and changes in net assets of future years when such adjustments, if any, become known.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

9. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets of \$107,926 and \$92,945 as of September 30, 2015 and 2014, respectively, are available to the Network for health care services and capital expenditures and include the Network's beneficial interest in a charitable remainder trust. Permanently restricted net assets total \$44,043 and \$43,258 as of September 30, 2015 and 2014, 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.

10. Endowments

The Network endowment consists of approximately 62 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 Network classifies net assets of donor-restricted endowment funds for organizations subject to an enacted Uniform Prudent Management of Institutional Funds Act (UPMIFA). Connecticut enacted its UPMIFA statute effective October 1, 2007. This standard requires not-for-profit organizations subject to an enacted version of UPMIFA to classify the portion of the endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time and purpose restricted) until appropriated for expenditure by the organization. The portion to be classified as temporarily restricted consists of accumulated unspent income and appreciation.

The 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

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Endowments (continued)

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

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 of Directors abides by these regulations and will adjust this rate accordingly.

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Endowments (continued)

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ —	\$ 13,451	\$ 37,037	\$ 50,488
Board-designated endowment funds	17,841	—	—	17,841
Endowment funds at end of year	<u>\$ 17,841</u>	<u>\$ 13,451</u>	<u>\$ 37,037</u>	<u>\$ 68,329</u>

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment funds at beginning of the year	\$ 9,785	\$ 17,333	\$ 35,501	\$ 62,619
Investment return:				
Investment income, net	236	974	—	1,210
Change in unrealized gains and losses	(680)	(2,648)	—	(3,328)
Total investment return	<u>(444)</u>	<u>(1,674)</u>	<u>—</u>	<u>(2,118)</u>
Contributions	10,000	183	1,536	11,719
Appropriation of endowment assets for expenditures	(1,500)	(2,542)	—	(4,042)
Other changes:				
Net asset reclassification-net loss on endowments	—	151	—	151
Endowment funds at end of year	<u>\$ 17,841</u>	<u>\$ 13,451</u>	<u>\$ 37,037</u>	<u>\$ 68,329</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Endowments (continued)

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ —	\$ 17,333	\$ 35,501	\$ 52,834
Board-designated endowment funds	9,785	—	—	9,785
Endowment funds at end of year	<u>\$ 9,785</u>	<u>\$ 17,333</u>	<u>\$ 35,501</u>	<u>\$ 62,619</u>

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment funds at beginning of the year	\$ 9,115	\$ 15,272	\$ 25,789	\$ 50,176
Acquisition of NHSC	—	3,597	9,462	13,059
Investment return:				
Investment income, net	170	902	—	1,072
Change in unrealized gains and losses	500	2,356	—	2,856
Total investment return	<u>670</u>	<u>3,258</u>	<u>—</u>	<u>3,928</u>
Contributions	—	353	131	484
Appropriation of endowment assets for expenditures	—	(5,028)	—	(5,028)
Other changes:				
Transfers to permanently restricted endowment	—	(119)	119	—
Endowment funds at end of year	<u>\$ 9,785</u>	<u>\$ 17,333</u>	<u>\$ 35,501</u>	<u>\$ 62,619</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Endowments (continued)

The primary long-term management objective for Network's endowment funds is to maintain the permanent nature of each endowment fund, while providing a predictable, stable, and constant stream of earnings. Consistent with that objective, the primary investment goal is to earn annual interest and dividends.

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 were \$151 in deficiencies of this nature which are reported in unrestricted net assets as of September 30, 2015. No deficiencies were reported for the year ended September 30, 2014.

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

11. Commitments and Contingencies

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

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

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

11. Commitments and Contingencies (continued)

Workers' Compensation Insurance

The Network is self-insured for workers' compensation benefits. Estimated liabilities of approximately \$9,789 and \$8,926, using a discount rate of 3.5% and 3.0-5.6% have been accrued as of September 30, 2015 and 2014, respectively, based on expected future payments pertaining to such years, and are included in accrued pension liabilities and other on the consolidated balance sheets.

Operating Leases

The Network leases property and equipment under noncancelable operating leases that expire in various years through 2028. Certain leases may be renewed at the end of their term.

Future minimum payments under noncancelable operating leases, and future receipts under noncancelable subleases where the Network is receiving rental receipts, with initial terms of one year or more consisted of the following at September 30, 2015:

	Operating Lease Payments	Sublease Rental Receipts
2016	\$ 24,632	\$ 2,993
2017	21,139	3,067
2018	20,590	2,836
2019	18,321	2,108
2020	16,735	1,838
Thereafter	62,143	2,870
	<u>\$ 163,560</u>	<u>\$ 15,712</u>

Rent expense was \$26,798 and \$22,916 for the years ended September 30, 2015 and 2014, respectively, and is included within supplies and other in the accompanying consolidated statements of operations. Rental income for the years ended September 30, 2015 and 2014, was approximately \$5,449 and \$4,342, respectively, and is included within other operating revenues in the accompanying consolidated statements of operations.

Western Connecticut Health Network, Inc. and Subsidiaries

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

12. Changes in Components of Operating Assets and Liabilities

	Year Ended September 30	
	2015	2014
(Increase) decrease in operating assets:		
Pledges receivable	\$ (10,355)	\$ 10,006
Accounts receivable, net	(53,417)	(63,674)
Inventories	(421)	(333)
Prepaid expenses and other assets	11,964	6,689
Bond issuance costs, net	549	489
	<u>(51,680)</u>	<u>(46,823)</u>
Increase (decrease) in operating liabilities:		
Accounts payable	(7,976)	(2,094)
Payroll-related accruals	201	6,113
Due to third-party payors	(7,361)	6,476
Interest payable	(80)	509
Other accrued expenses	(556)	242
Self-insurance liabilities	(7,074)	(12,668)
Accrued pension liabilities and other	(36,107)	(35,071)
	<u>(58,953)</u>	<u>(36,493)</u>
Change in working capital other than cash and cash equivalents	<u>\$ (110,633)</u>	<u>\$ (83,316)</u>

13. 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 WCHNF and NHF are as follows:

	Year Ended September 30	
	2015	2014
Healthcare services	\$ 870,685	\$ 751,061
General and administrative	275,062	236,994
Fundraising	4,312	3,520
	<u>\$ 1,150,059</u>	<u>\$ 991,575</u>

Western Connecticut Health Network, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

14. Other Operating Revenues

Other operating revenues consisted of the following:

	Year Ended September 30	
	2015	2014
Rental income	\$ 5,449	\$ 4,342
Grants	4,902	5,203
Captive malpractice insurance premiums	674	2,896
Captive investment income	938	1,273
Education	2,401	1,642
Research	642	541
EHR incentive payments	1,671	3,187
Dietary/nutrition	1,885	1,540
Ancillary services	1,256	913
Other income	5,706	3,563
	<u>\$ 25,524</u>	<u>\$ 25,100</u>

15. Subsequent Events

The Network has performed an evaluation of subsequent events through January 28, 2016, the date the consolidated financial statements were issued, and noted the following subsequent events.

In September 2015, the Board approved the merger of the Retirement Plan for Employees of Norwalk Hospital into the WCHN Pension Plan effective December 31, 2015. All plan assets and benefit obligations were transferred to WCHN as of the effective date.

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

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

Supplementary Information

Western Connecticut Health Network, Inc. and Subsidiaries

Consolidating Balance Sheet
(In Thousands)

September 30, 2015

Assets	The Danbury Hospital and Subsidiary	Western Connecticut Health Network, Inc. Foundation, Inc.	Western Connecticut Health Network, Inc.	The Norwalk Hospital Association and Subsidiaries	Western Connecticut Medical Group, P.C.	Eliminations	Subtotal Obligated Group	SWC Corporation	Western Connecticut Health Network Affiliates, Inc.	Western Connecticut Home Care, Inc.	Eliminations	Total
Current assets:												
Cash and cash equivalents	\$ 21,694	\$ 996	\$ 148	\$ 36,629	\$ 13,219	\$ -	\$ 86,316	\$ 924	\$ 1,391	\$ 668	\$ -	\$ 89,299
Investments, current portion	-	-	-	13,983	-	-	13,983	-	-	-	-	13,983
Assets limited as to use, current portion	7,568	-	-	-	-	-	7,568	-	-	-	-	7,568
Pledges receivable, current portion	-	17,965	-	23,303	-	-	41,268	-	-	-	-	41,268
Patient accounts receivable, less allowance for uncollectible accounts of approximately \$42,500	76,578	-	-	46,628	16,798	(8,627)	139,764	231	2,263	1,530	(919)	143,498
Due from related parties, current portion	6,294	-	435	40	2,520	-	62	257	-	-	-	14,800
Inventories	10,950	-	-	3,004	280	-	14,334	511	-	195	-	15,800
Prepaid expenses and other	17,238	10	73	4,325	1,114	-	22,869	133	156	133	4	23,100
Total current assets	140,482	18,571	655	148,992	31,931	(8,627)	336,004	1,923	3,810	2,488	(915)	351,308
Investments	166,957	12,659	-	120,441	-	-	300,027	-	-	1,008	-	301,035
Assets limited as to use:												
Funds received by donor	-	\$1,246	-	33,857	-	-	37,103	-	-	-	-	37,103
Board designated funds	-	8,441	-	28,493	-	-	36,934	-	-	-	-	36,934
Beneficial interest in trust held by others and charitable remainder trust	-	7,697	-	7,556	-	-	15,253	-	-	-	-	15,253
Construction funds	-	-	-	5,743	-	-	5,743	-	-	-	-	5,743
Investments held by WCHNC	115,882	-	-	-	-	-	115,882	-	-	-	-	115,882
Total noncurrent assets limited as to use	115,882	68,694	-	76,649	-	-	260,225	-	-	-	-	260,225
Other assets	2,801	203	10,376	3,125	7,886	(28,830)	23,791	-	-	-	-	23,791
Investment in NHSC	-	-	346,229	-	-	(346,250)	-	-	-	-	-	-
Interest in Western Connecticut Health Network Foundation, Inc. and Norwalk Hospital Foundation, Inc.	92,378	-	-	-	-	(92,378)	-	-	-	-	-	-
Due from related parties	-	-	1,266	-	2,016	(7,303)	-	-	2	-	(2)	-
Property, plant and equipment:												
Land and land improvements	12,208	-	-	37,942	-	-	40,722	-	-	-	-	40,722
Buildings and building improvements	511,129	707	12	229,740	255	-	741,834	406	3,344	19	-	746,403
Equipment and other	306,225	221	-	277,546	16,248	-	600,240	697	9,334	1,173	-	611,441
Construction in progress (estimated cost to complete as September 30, 2015: \$31,882)	16,765	-	-	86,191	3,016	-	106,072	-	-	-	-	106,072
Less accumulated depreciation	(846,419)	(460)	12	(61,419)	(30,419)	-	(938,689)	(1,103)	(2,678)	(1,107)	-	(943,587)
	(652,238)	(433)	(11)	(350,789)	(68,516)	-	(1,122,117)	(689)	(10,888)	(817)	-	(1,134,511)
Total property, plant and equipment	394,161	937	1	276,650	11,803	-	677,552	214	1,799	375	-	679,931
Pledges receivable, less current portion	-	4,846	-	1,746	-	-	6,592	-	-	-	-	6,592
Bond issuance costs, net	3,777	-	-	283	-	-	4,060	-	-	-	-	4,060
Total assets	\$ 316,438	\$ 106,070	\$ 398,518	\$ 645,928	\$ 55,656	\$ (479,387)	\$ 1,601,255	\$ 2,137	\$ 3,602	\$ 3,467	\$ (917)	\$ 1,611,943

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

Western Connecticut Health Network, Inc. and Subsidiaries

Consolidating Balance Sheet (continued)
(In Thousands)

September 30, 2015

	The Daenary Hospital and Subsidiary	Western Connecticut Health Network Foundation, Inc.	Western Connecticut Health Network, Inc.	The Norwalk Hospital Association and Subsidiaries	Western Connecticut Medical Group, P.C.*	Eliminations	Subtotal Obligated Group	SWC Corporation	Western Connecticut Health Network Affiliates, Inc.	Western Connecticut Home Care, Inc.	Eliminations	Total
Liabilities and net assets												
Current liabilities:												
Accounts payable	\$ 36,053	\$ -	\$ -	\$ 26,773	\$ 75	\$ -	\$ 62,803	\$ 317	\$ 129	\$ 292	\$ -	\$ 63,644
Prepaid/accrued amounts	36,988	146	509	15,167	15,347	-	68,145	500	473	172	-	69,290
Due to intermediary payors	16,232	-	-	27,894	-	-	46,126	-	-	149	-	46,275
Current portion of due to related parties	-	-	-	7,988	346	(8,627)	232	-	131	718	(1,081)	-
Interest payable	1,843	-	-	652	-	-	2,404	-	-	-	-	2,404
Other accrued expenses	2,790	80	201	17	781	-	3,779	-	4	34	-	3,817
Current portion of long-term debt	1,580	-	-	7,647	-	-	9,227	-	-	-	-	9,227
Total current liabilities	97,302	751	701	86,140	16,519	(8,627)	192,906	817	737	1,368	(1,081)	194,157
Self-insurance liabilities	78,958	-	-	24,879	-	(38,329)	78,958	-	-	-	-	78,958
Accrued pension liabilities and other	20,082	81	133,855	65,689	7,851	-	227,558	-	450	-	-	227,988
Due to related parties, less current portion	-	-	1,872	-	1,366	(1,302)	(164)	-	-	-	164	-
Long-term debt, less current portion	2,572,276	-	-	111,689	-	-	3,549,959	-	-	-	-	3,549,959
Trust liabilities	439,792	832	136,428	292,347	25,566	(40,758)	854,217	817	737	1,798	(917)	856,652
Net assets:												
Unrestricted	406,110	22,557	172,771	280,297	29,970	(318,653)	593,072	1,320	4,865	2,029	-	601,286
Unrestricted attributable to noncontrolling interest	-	-	-	2,035	-	-	2,035	-	-	-	-	2,035
Temporarily restricted	36,051	48,066	39,897	59,821	-	(75,939)	107,806	-	-	40	-	107,926
Permanently restricted	34,576	31,575	9,462	9,468	-	(44,027)	34,043	-	-	-	-	34,043
Total net assets	476,736	106,198	222,130	351,621	29,970	(438,629)	747,906	1,320	4,865	2,069	-	755,290
Total liabilities and net assets	\$ 916,438	\$ 208,030	\$ 208,030	\$ 643,968	\$ 55,656	\$ (499,987)	\$ 1,601,233	\$ 2,197	\$ 3,002	\$ 3,867	\$ (917)	\$ 1,611,942

* Includes Glens Falls New York Medical Services, P.C.

Western Connecticut Health Network, Inc. and Subsidiaries

Consolidating Statement of Operations
(In Thousands)

Year Ended September 30, 2015

	Western Connecticut Health Network Foundation, Inc.	Western Connecticut Health Network, Inc.	The Norwalk Hospital Association and Subsidiaries	Western Connecticut Medical Group, P.C.*	Eliminations	Subsidiary Obligated Group	SWC Corporation	Western Connecticut Health Network Affiliates, Inc.	Western Connecticut Home Care, Inc.	Norwalk Health Care Center	Business System, Inc.	Eliminations	Total
Unrestricted revenues:													
Net patient service revenue	\$ 614,030	\$ -	\$ 387,227	\$ 128,394	\$ (440)	\$ 1,129,241	\$ 11,857	\$ 12,757	\$ 8,419	\$ -	\$ -	\$ (540)	\$ 1,622,464
Provision for uncollectible accounts	21,154	-	13,242	2,782	-	33,578	61	432	290	(19)	-	-	36,612
Net patient service revenue less provision for uncollectible accounts	592,876	-	373,985	125,612	(440)	1,095,663	11,796	12,325	8,159	19	-	(540)	1,123,822
Net income retained from restriction	6,073	-	1,753	125	-	7,951	-	-	142	-	-	-	8,093
Other operating revenues	22,816	721	14,004	\$7,196	(99,580)	25,757	3,577	203	142	-	-	(4,184)	25,524
	622,765	721	389,742	213,133	(100,420)	1,122,771	15,373	12,528	8,472	19	-	(4,724)	1,157,639
Expenses:													
Salaries, benefits and fees	357,097	-	213,329	174,601	(84,114)	666,500	4,668	7,360	5,801	-	-	-	684,758
Supplies and other	178,223	1,381	111,776	33,653	(4,829)	320,457	10,140	5,350	2,625	-	6	(4,425)	334,175
Tenants	9,082	-	7,662	3,538	(11,385)	9,517	-	259	33	-	-	(302)	9,517
Depreciation and amortization	45,374	5	20,986	1,765	-	67,936	37	664	68,744	-	-	-	68,744
Interest	7,452	-	2,668	-	-	9,520	-	-	-	-	-	-	9,520
State of Connecticut Hospital Tax	24,492	-	14,644	-	-	30,046	-	-	-	-	-	-	30,046
	622,980	7,363	303,663	213,397	(100,395)	1,113,120	15,071	13,652	8,622	-	6	(4,724)	1,145,237
Income (loss) from operations before loss on extinguishment of long-term debt	(185)	-	19,707	(264)	(25)	12,651	302	(1,124)	(150)	19	(6)	-	11,602
Net (less) gain on extinguishment of long-term debt	(1,357)	-	2,625	-	-	1,268	-	-	-	-	-	-	1,268
(Loss) income from operations	(1,542)	-	(2,918)	(264)	(25)	(13,919)	302	(1,124)	(150)	19	(6)	-	(12,960)
Income tax expense	-	-	-	-	-	-	(160)	-	-	-	-	-	(160)
Nonoperating gains and (losses):													
Contributions	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment income, net	1,871	-	31,165	-	-	33,036	-	-	60	-	-	-	33,105
Change in unrealized gains and losses on investments	4,223	136	3,809	3	(56)	9,238	-	-	40	-	-	-	9,298
Change in equity interest in unaffiliated net assets of the Western Connecticut Health Network Foundation, Inc. and Norwalk Hospital Foundation, Inc.	(6,686)	-	(6,233)	-	-	(14,177)	-	-	(72)	-	-	-	(14,249)
Operating expenses of the Western Connecticut Health Network Foundation, Inc. & Norwalk Hospital Foundation, Inc.	(1,601)	-	-	-	1,601	-	-	-	-	-	-	-	-
Interest cost on interest rate swap	-	-	(2,086)	-	81	(4,312)	-	-	-	-	-	-	(4,312)
Interest cost on interest rate swap	-	-	(360)	-	-	(360)	-	-	-	-	-	-	(360)
Change in value of interest rate swap	-	-	(2,928)	-	-	(2,928)	-	-	-	-	-	-	(2,928)
	(4,065)	(333)	23,153	3	1,625	20,551	-	-	37	-	-	-	20,558
Excess (deficiency) of revenue over expense, before noncontrolling interest in joint venture	(5,660)	(333)	45,485	(261)	1,601	34,440	134	(1,124)	(113)	19	(6)	-	33,330
Less: net income attributable to noncontrolling interest in joint venture	-	-	(1,968)	-	-	(1,968)	-	-	-	-	-	-	(1,968)
Excess (deficiency) of revenue over expense	(5,660)	(333)	43,517	(261)	1,601	32,472	134	(1,124)	(113)	19	(6)	-	31,362

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