

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

**FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**
(With Management's Discussion and Analysis)

JUNE 30, 2016 AND 2015

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

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**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis provides an overview of the financial position and activities of the University of Connecticut Health Center John Dempsey Hospital (21002 Fund) (the Hospital) as of and for the years ended June 30, 2016, 2015 and 2014. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Through the Hospital (a licensed acute care hospital with a certified 234 general acute care beds, 193 staffed), the University of Connecticut Health Center (UConn Health) provides specialized and routine inpatient and outpatient services. The Hospital also provides comprehensive healthcare services for Connecticut's incarcerated inmates through contracts with the Correctional Managed Health Care (CMHC) program. The Hospital has long been regarded as the premier facility in the region for high-risk maternity services. It is also recognized for its cardiovascular program (interventional cardiology and surgery), cancer, musculoskeletal, and behavioral mental health services, ambulatory partial hospitalization, and outpatient treatment programs. Additionally, the Hospital is home to the only Emergency Department in Connecticut's Farmington Valley.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of management's discussion and analysis and the financial statements. The basic financial statements (statements of net position, statements of revenues, expenses, and changes in net position, and statements of cash flows) present the financial position of the Hospital at June 30, 2016 and 2015, and the results of its operations and its financial activities for the years then ended. These financial statements report information about the Hospital using accounting methods similar to those used by private-sector companies. The statements of net position include all of the Hospital's assets and liabilities. The statements of revenues, expenses, and changes in net position reflects the year's activities on the accrual basis of accounting, i.e., when services are provided or obligations are incurred, not necessarily when cash is received or paid. These financial statements report the Hospital's net position and how it has changed. Net position (the difference between assets and liabilities adjusted for deferred outflows and inflows) is one way to measure financial health or position. The statements of cash flows provide relevant information about each year's cash receipts and cash payments and classifies them as to operating, investing, and noncapital financing activities.

The Hospital adopted GASB statements 68 and 71 in fiscal 2015. Those statements required the Hospital to recognize its pro rata share of the State's pension liabilities as well as deferred inflows and outflows of resources. Those changes were made by adjusting the July 1, 2014 opening balance to record the cumulative change in net assets. In conjunction with the adoption of those standards the Hospital decreased its beginning net position in fiscal 2015 by \$138.7 million though there was no effect on cash flows.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS

Hospital discharges of 9,061 represent an increase of 115 cases from 2015. Outpatient visits increased by 28,241, or 8%, from the prior year. These changes are indicative of the general healthcare trend towards outpatient treatment.

The Hospital finished the year with an operating gain of \$4.2 million compared to \$19.5 million in the prior year. The Hospital received net transfers from UConn Health of \$281.3 million and \$8.0 million in 2016 and 2015, respectively. Current year transfers include \$8.0 million of fringe benefit recoveries related to support services paid against the institutions' general fund allotment and \$273.3 million of transfers related to construction of the new University Tower at John Dempsey Hospital. Total net position increased \$4.2 million from operations in fiscal 2016, compared to an increase of \$19.5 million in fiscal 2015. The Hospital's financial position at June 30, 2016, included assets of approximately \$447.1 million, deferred outflows of \$50.4 million, liabilities of approximately \$251.3 million and no deferred inflows. Net position, which represents the residual interest in the Hospital's assets and deferred outflows after liabilities and deferred inflows are deducted, increased \$285.8 million to approximately \$246.2 million from fiscal year 2015.

Changes in net position represent the activity of the Hospital, resulting from revenues, expenses, gains, losses, transfers and cumulative effect of change in accounting principles and are summarized for the years ended June 30, 2016, 2015, and 2014, including other changes in net position, as follows:

	2016	2015	2014
	<i>(in thousands)</i>		
Summary of assets, liabilities and net position at June 30:			
Current assets	\$ 105,405	\$ 89,222	\$ 67,324
Other assets	9,839	9,801	9,702
Capital assets, net	<u>331,853</u>	<u>50,492</u>	<u>51,704</u>
Total assets	<u>\$ 447,097</u>	<u>\$ 149,515</u>	<u>\$ 128,730</u>
Deferred outflows	<u>\$ 50,380</u>	<u>\$ 16,039</u>	<u>\$ --</u>
Current liabilities	\$ 53,716	\$ 42,749	\$ 48,824
Pension liabilities	188,358	148,375	--
Accrued compensated absences, noncurrent portion	<u>9,238</u>	<u>8,724</u>	<u>8,551</u>
Total liabilities	<u>\$ 251,312</u>	<u>\$ 199,848</u>	<u>\$ 57,375</u>
Deferred inflows	<u>\$ --</u>	<u>\$ 5,303</u>	<u>\$ --</u>
Net investment in capital assets	\$ 331,853	\$ 50,492	\$ 51,704
Unrestricted	<u>(85,688)</u>	<u>(90,089)</u>	<u>19,651</u>
Total net position	<u>\$ 246,165</u>	<u>\$ (39,597)</u>	<u>\$ 71,355</u>

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS (CONTINUED)

	2016	2015	2014
	<i>(in thousands)</i>		
Summary of revenues, expenses and transfers for the year ended June 30:			
Operating revenues	\$ 378,071	\$ 360,296	\$ 308,713
Operating expenses	<u>(373,829)</u>	<u>(340,779)</u>	<u>(326,572)</u>
Operating Income (Loss)	4,242	19,517	(17,859)
Nonoperating revenue, net	<u>196</u>	<u>200</u>	<u>414</u>
Income (Loss) before loss on disposal of Dental Clinics and transfers	4,438	19,717	(17,445)
Loss on disposal of Dental Clinics	--	--	(3,850)
Net transfers	281,324	8,002	12,976
Cumulative effect of change in accounting principle	<u>--</u>	<u>(138,671)</u>	<u>--</u>
Increase (Decrease) in net position	<u>\$ 285,762</u>	<u>\$ (110,952)</u>	<u>\$ (8,319)</u>

CAPITAL ASSETS

At June 30, 2016, the Hospital had property, plant, and equipment of \$477.5 million before accumulated depreciation compared to \$193.6 million at June 30, 2015. Buildings increased \$260.2 million in 2016 mostly related to the new Hospital, as shown in the table below:

	2016	2015	2014
	<i>(in thousands)</i>		
Land	\$ 183	\$ 183	\$ 183
Construction in progress	24,275	14,703	11,802
Buildings	355,780	95,594	93,653
Equipment	85,711	69,309	71,502
Capital leases	<u>11,592</u>	<u>13,776</u>	<u>13,776</u>
Total Property, Plant and Equipment	<u>\$ 477,541</u>	<u>\$ 193,565</u>	<u>\$ 190,916</u>

For fiscal 2017 all UConn Health capital requests will be considered for funding on an individual basis. Capital requests will be considered by the senior executive committee of UConn Health. More detailed information about the Hospital's property, plant and equipment is presented in note 7 to the financial statements.

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JOHN DEMPSEY HOSPITAL (21002 FUND)**

MANAGEMENT'S DISCUSSION AND ANALYSIS

STATEMENTS OF CASH FLOWS

The statements of cash flows provide additional information about the Hospital's financial results by reporting the major sources and uses of cash. A summary of the statements of cash flows for the years ended June 30, 2016, 2015, and 2014 is as follows:

	2016	2015	2014
	<i>(in thousands)</i>		
Cash received from operations	\$ 382,751	\$ 373,977	\$ 304,520
Cash expended for operations	<u>(362,364)</u>	<u>(334,388)</u>	<u>(315,683)</u>
Net cash provided by/(used) in operations	20,387	39,589	(11,163)
Net cash used in investing activities	(17,333)	(7,017)	(7,781)
Net cash provided by/(used) in noncapital financing activities	<u>8,588</u>	<u>(8,267)</u>	<u>18,944</u>
Net change in cash	11,642	24,305	--
Cash - Beginning	<u>24,305</u>	<u>--</u>	<u>--</u>
Cash - Ending	<u><u>\$ 35,947</u></u>	<u><u>\$ 24,305</u></u>	<u><u>\$ --</u></u>

SIGNIFICANT VARIANCES IN FINANCIAL STATEMENTS

In this section, the Hospital explains the reasons for those financial statement items with significant variances relating to fiscal 2016 amounts compared to fiscal 2015.

SUMMARY OF ASSETS AND LIABILITIES

Changes in assets included the following:

Cash – increased from June 30, 2015 to June 30, 2016 by approximately \$11.6 million to \$35.9 million. UConn Health transferred \$8.0 million to the Hospital in fiscal year 2016. The Hospital received Medicaid and Medicare settlements of \$4.6 million and \$2.2 million, respectively.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

SUMMARY OF ASSETS AND LIABILITIES (CONTINUED)

Inventory – increased from June 30, 2015 to June 30, 2016 by approximately \$1.5 million. The increase was driven by inventory needed to stock additional clinical space associated with the new University Tower at John Dempsey Hospital.

Contract and other receivables – increased from June 30, 2015 to June 30, 2016 by approximately \$823,000. The increase was driven by the contract between the Hospital and Connecticut Children's whereby Connecticut Children's pays the Hospital for costs associated with its administration of the Neonatal Intensive Care Unit (NICU), and represents increased rental, personnel, and other costs associated with the agreement.

Capital Assets – increased from June 30, 2015 to June 30, 2016 by approximately \$281.4 million. The increase was driven by the transfer and capitalization of the new University Tower at John Dempsey Hospital which was open for service in May 2016.

Changes in liabilities included the following:

Due to third-party payors – increased from June 30, 2015 to June 30, 2016 by approximately \$7.2 million. This change is related to estimated and actual settlements. These amounts are the result of management's analysis of outstanding Medicare and Medicaid cost reports and other potential settlement of claims with HMOs.

Accounts payable and accrued expenses – increased from June 30, 2015 to June 30, 2016 by approximately \$2.0 million. This represents normal balances in accounts payable for the current year.

Pension liability – increased in the current year due to changes in the Hospital's pension allocation. The Hospital ended the year with a liability of \$188.4 million which represents its proportional share of the State's Employees' Retirement System (SERS) and Teachers' Retirement System pension plans as determined by the Hospital's percentage of overall contributions.

SUMMARY OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

Operating revenue – increased from June 30, 2015 to June 30, 2016 by approximately \$17.8 million or 4.9%. Net patient revenues went up \$14.6 million or 4.3% due to increased volume and strategic pricing changes. The Hospital reported approximately \$900,000 and \$1.8 million in contract revenue from meaningful use during the years ended June 30, 2016 and 2015, respectively.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

SUMMARY OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION (CONTINUED)

Operating expenses – increased from June 30, 2015 to June 30, 2016 by approximately \$33.0 million or 9.7%. Fringe benefits increased approximately \$9.8 million in 2016 consistent with an increase in salaries of \$9.7 million. In 2016 total FTE's were 1,333 compared to 1,277 in 2015. Drugs and medical supplies increased \$2.8 million. Internal contractals increased by \$12.9 million, including an increase in internally allocated rent of approximately \$4.8 million related to the Outpatient Pavilion.

Transfers from UConn Health – increased from June 30, 2015 to June 30, 2016 by approximately \$273.3 million. This increase is mostly related to the new Hospital Tower which was held on the UConn Health financial statements until fiscal year 2016 when it was transferred to the Hospital.

FISCAL 2017 OUTLOOK

As we look forward to fiscal year 2017, the Hospital's focus is on providing outstanding clinical care while growing its volume and managing its bottom line. Fiscal 2016 saw the completion of the University Tower at John Dempsey Hospital. This new, state of the art facility has expanded the number of medical/surgical beds available. Together, the University Tower and the Outpatient Pavilion, provide the Hospital with a competitive advantage over peers with aging facilities. The Hospital is concentrating on leveraging these new facilities along with its status as an academic medical center and outstanding quality reputation to compete for volume in the central Connecticut and Farmington Valley regions. New advertising campaigns will further establish our presence and identity in the region.

In 2016, the Hospital had higher discharges but also a shorter length of stay than in 2015. As a result, the average daily census was lower in the current year. Combined with University Tower's increased capacity, the Hospital has the room to increase patient volumes. The Hospital has benefited and will continue to benefit from increases in volume at the University Medical Group (UMG). It is expected that increased UMG volume will drive additional business to the Hospital in 2017. At the same time, the Hospital's outpatient equivalents were higher than the prior year reflecting strong growth in the Hospital's outpatient service lines.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FISCAL 2017 OUTLOOK (CONTINUED)

Healthcare reform and shifting regional and national dynamics continue to bring changes in the way hospitals serve their communities. The Hospital is not exempt from these forces. In 2016, the Hospital took the first steps towards joining Hartford Healthcare in an Accountable Care Organization (ACO). The two entities will be working toward solidifying their relationship over the next year.

Management also continues to focus on reducing costs where appropriate. The Hospital's costs rose approximately 9.7% from 2015. These increases were driven by increases in salary and fringe benefit costs. As such, the Hospital puts a premium on each new position to ensure that it is required and is utilized fully. The Hospital remains vigilant in analyzing its drug and medical supply expenses.

The Hospital, as part of UConn Health, has begun installation of UConn HealthONE, an EPIC installation. The installation will result in the installation of the EPIC system at both UConn John Dempsey Hospital and UMG, linking patients via a single electronic health record (EHR) and positions the Hospital for compliance with the third stage of meaningful use requirements. This endeavor will require a complete reevaluation of the Hospital's business office functions as well as potential operational changes. The installation is scheduled to complete by the end of fiscal 2018.

Management will continue to monitor these and other factors over the upcoming year as it seeks to strengthen the Hospital for the future.

BIOSCIENCE CONNECTICUT

Progress on the construction work related to the Bioscience Connecticut initiative continued with several projects reaching completion. The new John Dempsey Hospital University Tower, which also includes the 3rd and final parking garage, opened in April, 2016. Work on the final phase of the project is underway and will be complete by late 2016. The remaining work on the 8th floor of the Outpatient Pavilion (formerly named the Ambulatory Care Center) was completed and the building was 100% occupied by mid-September 2016. The Main Building Lab Renovations – Project 1 is complete and Project 2 is underway and on schedule to complete in mid-March, 2017. Construction of the Academic Building addition is complete and the schools are using the new classrooms to advance their curriculum changes. The renovation work associated with the project will continue through May 2017. The Incubator Lab addition to the Cell and Genome Sciences Building was completed in January and the labs are now being leased to companies for technology development. The Clinic Building renovations began construction in July and the work will continued through early 2018. The first phase of work and renovation to the Main Lobby are scheduled to be complete in early 2017.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

CONTACTING THE HOSPITAL'S FINANCIAL MANAGEMENT

This financial report provides the reader with a general overview of the Hospital's finances and operations. If you have questions about this report or need additional financial information, please contact the Office of the Chief Financial Officer, University of Connecticut Health Center, Farmington, Connecticut 06030-3800.



INDEPENDENT AUDITORS' REPORT

Joint Audit and Compliance Committee
University of Connecticut Health Center

Report on the Financial Statements

We have audited the accompanying financial statements of the University of Connecticut Health Center John Dempsey Hospital (21002 Fund) (the Hospital), an enterprise fund of the State of Connecticut, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from 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 auditors' 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, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Connecticut Health Center John Dempsey Hospital (21002 Fund) as of June 30, 2016 and 2015, and the results of its operations and changes in net position, and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the required supplementary information, such as Management's Discussion and Analysis on pages 1 through 8, the Schedule of Changes in the Hospital's Net Pension Liability and Related Ratios on page 47 and the Schedule of Pension Contributions on Page 48, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2016 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

Marcum LLP

Hartford, CT
October 31, 2016

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

STATEMENTS OF NET POSITION

JUNE 30, 2016 AND 2015

	2016	2015
Assets		
Current Assets		
Cash	\$ 35,947,283	\$ 24,305,080
Patient accounts receivable, net of estimated uncollectibles of \$24,941,000 and \$22,528,000 at June 30, 2016 and 2015, respectively	40,048,674	38,296,752
Inventory	8,953,005	7,446,576
Contract and other receivables	8,840,322	8,017,666
Due from Finance Corporation, current portion	5,703,122	5,710,122
Prepaid expenses	5,912,325	5,445,640
Total Current Assets	105,404,731	89,221,836
Noncurrent Assets		
Other assets	803,469	765,629
Due from Finance Corporation, noncurrent portion	9,035,784	9,035,784
Capital assets, net (note 7)	331,852,958	50,491,734
Total Noncurrent Assets	341,692,211	60,293,147
Total Assets	447,096,942	149,514,983
Deferred Outflows of Resources		
Deferred amount for pensions	50,380,333	16,039,083

The accompanying notes are an integral part of these financial statements.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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STATEMENTS OF NET POSITION (CONTINUED)

JUNE 30, 2016 AND 2015

	2016	2015
Liabilities and Net Position		
Current Liabilities		
Accounts payable and accrued expenses	\$ 12,391,589	\$ 10,381,117
Accrued payroll	6,681,872	5,426,177
Due to UConn Health Malpractice Fund	260,676	260,676
Due to State of Connecticut	3,981,581	3,055,636
Due to third-party payors	23,955,553	16,725,852
Deferred revenues	25,106	--
Accrued compensated absences, current portion (note 8)	6,420,026	6,899,653
Total Current Liabilities	53,716,403	42,749,111
Noncurrent Liabilities		
Pension liabilities	188,357,595	148,374,928
Accrued compensated absences, net of current portion (note 8)	9,238,574	8,724,561
Total Noncurrent Liabilities	197,596,169	157,099,489
Total Liabilities	251,312,572	199,848,600
Deferred Inflows of Resources		
Deferred amount for pensions	--	5,302,978
Net Position		
Net investment in capital assets	331,852,958	50,491,734
Unrestricted	(85,688,255)	(90,089,246)
Total Net Position	\$ 246,164,703	\$ (39,597,512)

The accompanying notes are an integral part of these financial statements.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
Operating Revenues		
Net patient service revenues (note 5)	\$ 351,910,875	\$ 337,300,171
Contract and other revenues	26,160,445	22,995,416
Total Operating Revenues	<u>378,071,320</u>	<u>360,295,587</u>
Operating Expenses		
Salaries and wages	116,973,417	107,310,852
Fringe benefits	67,192,452	57,429,802
Medical/dental house staff	2,987,242	2,138,571
Medical contractual support	156,931	647,034
Internal contractual support	71,866,226	58,941,140
Outside agency per diems	1,272,597	788,427
Depreciation and amortization	8,910,972	7,879,044
Pharmaceutical/medical supplies	61,621,182	58,778,144
Utilities	2,318,673	2,179,542
Outside and other purchased services	28,966,411	31,469,406
Insurance	3,399,757	3,390,766
Repairs and maintenance	5,714,448	7,729,172
Other expenses	2,448,615	2,097,358
Total Operating Expenses	<u>373,828,923</u>	<u>340,779,258</u>
Operating Income	<u>4,242,397</u>	<u>19,516,329</u>
Nonoperating Revenues (Expenses)		
Gift income	550,000	550,000
Loss on disposals	(354,307)	(350,209)
Net Nonoperating Revenues	<u>195,693</u>	<u>199,791</u>
Income before Transfers	4,438,090	19,716,120
Transfers from UConn Health - Unrestricted (note 10)	8,030,748	8,002,293
Transfers from UConn Health for new Hospital Tower (note 10)	<u>273,293,377</u>	<u>--</u>
Increase in Net Position	<u>285,762,215</u>	<u>27,718,413</u>
Net Position - Beginning of year (as previously stated)	(39,597,512)	71,355,029
Cumulative Effect of Implementing GASB 68 and 71	<u>--</u>	<u>(138,670,954)</u>
Net Assets - Beginning of year as restated	<u>(39,597,512)</u>	<u>(67,315,925)</u>
Net Position - End of year	<u>\$ 246,164,703</u>	<u>\$ (39,597,512)</u>

The accompanying notes are an integral part of these financial statements.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
Cash Flows from Operating Activities		
Cash received from patients and third-party payors	\$ 357,388,654	\$ 344,680,802
Cash received from contract and other revenue	25,362,895	29,296,254
Cash paid to employees for salaries and fringe benefits	(181,949,843)	(163,397,124)
Cash paid for other than personnel services	(180,414,125)	(170,990,442)
Net Cash Provided by Operating Activities	<u>20,387,581</u>	<u>39,589,490</u>
Cash Flows from Investing Activities		
Additions to property and equipment	(17,333,126)	(7,016,896)
Net Cash Used in Investing Activities	<u>(17,333,126)</u>	<u>(7,016,896)</u>
Cash Flows from Noncapital Financing Activities		
Gifts received	550,000	550,000
Transfer from UConn Health	8,030,748	8,002,293
Cash received from Finance Corporation	7,000	2,000,000
Net repayments on cash overdraft	--	(18,819,807)
Net Cash Provided by (Used in) Noncapital Financing Activities	<u>8,587,748</u>	<u>(8,267,514)</u>
Net Change in Cash	11,642,203	24,305,080
Cash - Beginning	<u>24,305,080</u>	<u>--</u>
Cash - Ending	<u>\$ 35,947,283</u>	<u>\$ 24,305,080</u>

The accompanying notes are an integral part of these financial statements.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
Reconciliation to Operating Income		
to Net Cash Provided by Operating Activities		
Operating income	\$ 4,242,397	\$ 19,516,329
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	8,910,972	7,879,044
Non-cash portion of pension expense	338,440	(1,032,131)
Changes in operating assets and liabilities:		
Patient accounts receivable, net	(1,751,922)	(4,853,647)
Inventory	(1,506,429)	213,615
Contract and other receivables	(822,656)	6,300,838
Prepaid expenses	(466,685)	(1,254,037)
Other assets	(37,840)	(98,988)
Due to third-party payors	7,229,701	12,234,278
Accounts payable and accrued expenses	2,010,471	644,040
Deferred revenues	25,106	--
Due to State of Connecticut	925,945	349,980
Due to UConn Health Malpractice Fund	--	(1,303,381)
Accrued payroll	1,255,695	452,320
Accrued compensated absences	34,386	541,230
	<u>\$ 20,387,581</u>	<u>\$ 39,589,490</u>
Net Cash Provided by Operating Activities	<u>\$ 20,387,581</u>	<u>\$ 39,589,490</u>

The accompanying notes are an integral part of these financial statements.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

The financial statements include those assets, deferred outflows, liabilities, deferred inflows, revenue, and expense accounts reflected in the accounting records of University of Connecticut Health Center John Dempsey Hospital (the Hospital), which are primarily accounted for in the 21002 Fund of the University of Connecticut Health Center (UConn Health). There are 21 members of the Board of Trustees of the University of Connecticut. Five serve as ex officio, voting members by virtue of other positions: The Governor is President of the Board, the Commissioners of Agriculture, Education, and Economic and Community Development are Board members, and the Chair of UConn Health's Board of Directors is a member. Two Board members are elected by alumni for four-year terms (and may be re-elected once, in succession). One undergraduate student is elected by undergraduates for a two-year term. One graduate or professional student is elected by graduate and professional students for a two-year term. Twelve members are appointed by the Governor, subject to confirmation by the General Assembly, for six-year terms, and may be reappointed without limit.

There are 18 members of the University of Connecticut Health Center Board of Directors. Three serve as ex officio voting members and serve concurrently with their positions: The Commissioner of Public Health, The Secretary or a designated under-secretary of the Office of Policy and Management, and the President of the University. All other terms are for three years and include: three members appointed by the Governor, three members appointed by the Chair of the Board of Trustees (two of which must be members of the Board of Trustees and one who serves as the Chair of the Board of Directors), and 9 at-large members appointed by the Board of Directors itself.

The Hospital is an enterprise fund of the State of Connecticut (the State) and is therefore generally exempt from federal income taxes under Section 115 of the Internal Revenue Code of 1986.

The University of Connecticut Health Center Finance Corporation (Finance Corporation) was established pursuant to Public Act No 87-458. The purpose of the Finance Corporation is to provide greater flexibility for the Hospital and to promote more efficient provision of health care services. As such, the Finance Corporation has been empowered to purchase supplies and equipment, acquire facilities, approve write-offs of Hospital accounts receivable, process malpractice claims on behalf of the Hospital and UConn Health, as well as negotiate joint ventures, shared service, and other agreements for the benefit of the Hospital.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

BASIS OF PRESENTATION

The Hospital's financial statements are prepared in accordance with all relevant Governmental Accounting Standards Board (GASB) pronouncements.

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify, in the context of the current governmental financial reporting environment, the hierarchy of accounting principles generally accepted in the United States of America (GAAP). During the year ended June 30, 2016, the Hospital adopted Statement No. 76 and it did not have material impact on the Hospital's financial statements.

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*. This Statement addresses accounting and financial reporting issues related to fair value measurements. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2015. During the year ended June 30, 2016, the Hospital adopted this standard and it did not have a material impact on the Hospital's financial statements based on the composition of the Hospital's assets and liabilities.

PROPRIETARY FUND ACCOUNTING

The Hospital utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Financial statement areas where management applies the use of estimates consist primarily of the allowance for uncollectible accounts, contractual allowances, pension liabilities, and third-party reimbursement reserves.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CASH

Cash includes cash held on behalf of the Hospital by the State of Connecticut.

ACCOUNTS RECEIVABLE AND NET PATIENT SERVICE REVENUES

Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. For financial statements, settlements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

The amount of the allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in Medicare and Medicaid health care coverage and other collection indicators. See note 5 for additional information relative to third-party payor programs.

CONTRACT AND OTHER REVENUES

Contract and other revenues primarily consist of services provided to area hospitals under the terms of contractual agreements. Revenue is recorded on the accrual basis of accounting in the period the related services are rendered.

INVENTORY

Inventory, with the exception of pharmaceuticals, is recorded at cost, being determined by the first-in, first-out (FIFO) method. Pharmaceuticals are valued at market value which approximates cost due to high turnover rates. Short-term or minor supplies are expensed as incurred.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CAPITAL ASSETS

Property and equipment acquisitions are recorded at cost. Betterments and major renewals are capitalized and maintenance and repairs are expensed as incurred.

Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Buildings have an estimated useful life of 5 to 50 years and equipment has an estimated useful life of 2 to 25 years. Assets acquired under capital leases and leasehold improvements are depreciated no longer than the lease term.

Construction in progress is capitalized as costs are incurred during the construction phase and depreciation will begin once the assets are placed in service.

IMPAIRMENT OF LONG-LIVED ASSETS

The Hospital records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. During the year ended June 30, 2016, management performed an analysis of the remaining net book value of the original John Dempsey Hospital Connecticut Tower when the new adjoining University Tower at John Dempsey Hospital (University Tower) was placed in service and concluded that there were no impairment losses based on the continued use of the remaining capital assets. There were no impairment losses in 2016 and 2015.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RETIREMENT PLANS AND OTHER POSTEMPLOYMENT BENEFITS

Eligible Hospital employees, as defined, may participate in the following State retirement plans: the State Retirement System Tier I, Tier II, Tier Ila, ARP Hybrid and the Teachers' Retirement System defined benefit plans; and the Alternate Retirement Plan which is a defined contribution plan. These plans are funded by contributions from the State as well as payroll deductions from employees, except for the Tier II Plan, which is noncontributory.

In addition, eligible employees may participate in a State defined contribution deferred compensation plan, which is funded by payroll deductions from employees. The State is statutorily responsible for the pension benefits of Hospital employees who participate in the aforementioned defined benefit plans. The State is required to contribute at an actuarially determined rate, which may be reduced by an act of the State legislature. These plans do not issue stand-alone financial reports. Summary information on the plans is publicly available in the State of Connecticut's Comprehensive Annual Financial Report.

In 2008, the State implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The State provides post retirement health care and life insurance benefits to eligible UConn Health employees, including those of the Hospital, in accordance with Sections 5-257(d) and 5-259(a) of the Connecticut General Statutes.

Upon retirement, liability for other retirement benefits rests with the State. Therefore, the liability is reported by the State and not recognized in the financial statements of the Hospital. As described in note 2, the Hospital will be required to record its proportionate share of this liability during the year ending June 30, 2018 under the provisions of GASB Statement No. 75. When employees retire, the State pays up to 100% of their health care insurance premium cost (including the cost of dependent coverage). The State finances the cost of post retirement health care and life insurance benefits on a pay-as-you-go basis through an appropriation from the General Fund.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RETIREMENT PLANS AND OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

During the year ended June 30, 2015, the Hospital adopted GASB Statements No. 68 *Accounting and Financial Reporting for Pensions* and No. 71 *Pension Transition for Contributions Made Subsequent to the Measurement Date*. These GASB pronouncements require the pro rata share of State pension liabilities to be recorded at the entity level. The Hospital continues to pay into State retirement plans on a pay-as-you-go basis but has recorded its liability as prescribed by the pronouncements. GASB 68 affects pensions only and does not supersede GASB 45. See note 2 regarding the implementation of GASB 68.

COMPENSATED ABSENCES

The Hospital's employees earn vacation, personal, compensatory and sick time at varying rates depending on their collective bargaining units. Employees may accumulate sick leave up to a specified maximum. Employees are not paid for accumulated sick leave if they leave before retirement. However, employees who retire from the Hospital may convert accumulated sick leave to termination payments at varying rates, depending on the employee's contract. Amounts recorded on the statements of net position are based on historical experience. All other compensated absences are accrued at 100% of their balance. Compensated absences have been allocated between current and noncurrent based on historical information.

THIRD-PARTY PAYORS

Laws governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Each year as the Office of Inspector General's (OIG) work plan changes, new areas of scrutiny surface. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in any given period.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

MEDICAL MALPRACTICE

Health care providers and support staff of the Hospital are fully protected by State Statutes from any claim for damage or injury, not wanton, reckless or malicious, caused in the discharge of their duties or within the scope of their employment (statutory immunity). Any claims paid for actions brought against the State as permitted by waiver of statutory immunity have been charged against UConn Health's malpractice self-insurance fund. UConn Health retains a qualified actuary to assist with calculating and determining the appropriate annual malpractice reserve. UConn Health allocates an annual malpractice premium to the Hospital, designed to reflect an estimate of the current year's cash claims to be processed. For the years ended June 30, 2016 and 2015, premiums were approximately \$3.1 million. These premiums are included in insurance expense in the Hospital's statements of revenues, expenses, and changes in net position. The due to UConn Health Malpractice Fund reported on the statements of net position represented premiums payable for occurrence based coverage through June 30, 2016 and 2015.

NET POSITION

Net position is classified in two components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the current balances outstanding of any borrowings (less amounts held in trust) used to finance the purchase or construction of those assets. All other assets less liabilities are classified as unrestricted.

PENSION LIABILITIES

In accordance with GASB 68, the Hospital records its proportionate share of collective net pension liability and collective pension expense for each defined benefit plan offered to its employees. The collective net pension liability for each plan is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is the portion of the actuarial present value of projected benefits payments that are attributable to the past periods of plan member service. Information about the fiduciary net position and additions to/deductions from each pension plan's fiduciary net position have been determined on the same basis as they are reported by each pension plan.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PENSION LIABILITIES (CONTINUED)

For this purpose, plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized in the period in which the contributions are appropriated. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

DEFERRED OUTFLOWS OF RESOURCES AND DEFERRED INFLOWS OF RESOURCES

The Hospital reports its proportionate share of collective deferred outflows of resources and collective deferred inflows of resources related to its defined benefit plans. Differences between expected and actual experience in the measurement of the total pension liability, changes of assumptions or other inputs, and differences between actual contributions and proportionate share of contributions are classified as either deferred outflows or deferred inflows, and are recognized over the average of the expected remaining service lives of employees eligible for pension benefits. The net differences between projected and actual earnings on pension plan investments are reported as deferred outflows or deferred inflows and are recognized over five years. Contributions to the pension plan from the Hospital subsequent to the measurement date of the net pension liability and before the end of the reporting period are reported as a deferred outflow of resources related to pensions.

REGULATORY MATTERS

The Hospital is required to file semi-annual and annual operating information with the State's Office of Health Care Access (OHCA) and is required to file annual cost reports with Medicare and Medicaid.

RECLASSIFICATIONS

Certain 2015 amounts, including the reclassification of \$3,853,375 of expenses from medical contractual support expense to internal contractual expense, have been reclassified to conform to the current year presentation.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 2 - CHANGE IN METHOD FOR ACCOUNTING FOR PENSIONS AND UPCOMING ACCOUNTING PRONOUNCEMENTS

As of July 1, 2014, the Hospital adopted GASB 68 and GASB 71. GASB 68 requires employers to recognize liabilities, deferred outflows of resources and deferred inflows of resources for their proportionate share of the pension plans that they participate in. As the State Employees' Retirement System (SERS) and Teachers' Retirement System (TRS) did not have a practical way to provide each of its component units with all of the information needed to fully restate their prior period financial statements, the Hospital has elected to apply the "cumulative effect" method, as permitted by GASB 68, by restating beginning net position as of July 1, 2014. The implementation of this standard resulted in an adjustment to reduce the Hospital's beginning net position by \$138.7 million as of July 1, 2014.

GASB 71 requires that, at transition, a government recognize a deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the net pension liability and the end of the government's reporting period. The provisions of this Statement are required to be applied simultaneously with the provisions of GASB 68. As of July 1, 2014, the Hospital recorded an adjustment to increase beginning net position by \$11.7 million for contributions made to SERS for service during the period from July 1, 2013 through June 30, 2014.

The cumulative effect of applying GASB 68 and 71 is reported as a restatement of 2015 beginning net position. The following table shows the impact of the cumulative effect method of adopting and implementing GASB 68 and 71 on beginning net position.

	<i>(in millions)</i>
Net position, beginning of period,	
July 1, 2014 (as previously stated)	\$ 71.4
Cumulative effect of adopting GASB 68 and 71	<u>(138.7)</u>
Net position, beginning of period,	
July 1, 2014 (as restated)	<u>\$ (67.3)</u>

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 2 - CHANGE IN METHOD FOR ACCOUNTING FOR PENSIONS AND UPCOMING ACCOUNTING PRONOUNCEMENTS (CONTINUED)

UPCOMING ACCOUNTING PRONOUNCEMENTS

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. The provisions of this Statement are effective for financial statements with periods beginning after June 15, 2016. The Hospital is currently evaluating the impact this standard will have on its financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. The provisions of this statement are effective for financial statements with periods beginning after June 15, 2016. The Hospital is currently evaluating the impact this standard will have on its financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions*, which will require additional disclosures and the recording of the Hospital's proportionate share of the net liabilities related to its participation in the postemployment benefit plans on the statements of net position and requires supplementary information about the postemployment liabilities. This Statement is effective for fiscal year beginning June 15, 2017. The Hospital is evaluating the impact this standard will have on its financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - An Amendment of GASB Statements No. 67, No. 68, and No. 73*. The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, No. 68, and No. 73. Specifically, this statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee contribution requirements. The provisions of this statement are effective for financial statements with periods beginning after June 15, 2016. The Hospital is currently evaluating the impact this standard will have on its financial statements.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 3 - HYPOTHECATION

In accordance with State Statute, the Hospital can borrow from the State up to 90% of its net patient receivables, contract and other receivables to fund operations. As of June 30, 2016 and 2015, the Hospital had not drawn down any funds under the hypothecation. As of June 30, 2016 and 2015, the Hospital had available \$44,000,096 and \$41,682,976, respectively, under the State Statute.

NOTE 4 - CHARITY CARE

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy, the estimated cost of those services and supplies, and equivalent service statistics. During 2016 and 2015, the Hospital provided charity care services of \$436,729 and \$327,517, respectively. The cost of these services was \$201,069 and \$159,281, respectively. No net patient service revenue was recorded for these services; however, expenses associated with these services were included in operating expenses.

NOTE 5 - NET PATIENT SERVICE REVENUES

The Hospital provides health care services primarily to residents of the region. Revenues from the Medicare program accounted for approximately 48% and 46% of the Hospital's net patient service revenues for the years ended June 30, 2016 and 2015, respectively. Revenues from the Medicaid program accounted for approximately 31% of the Hospital's net patient service revenues for both years ended June 30, 2016 and 2015.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 5 - NET PATIENT SERVICE REVENUES (CONTINUED)

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

Patient accounts receivable included approximately 38% and 33% due from Medicare and approximately 15% and 17% due from Medicaid at June 30, 2016 and 2015, respectively.

Patient service revenues reported net of allowances for the years ended June 30, were:

	2016	2015
Gross patient service revenues	\$ 842,247,138	\$ 740,812,802
Less contractual allowances	(484,302,196)	(394,107,610)
Less provision for bad debt	(6,034,067)	(9,405,021)
Net patient service revenues	\$ 351,910,875	\$ 337,300,171

The Hospital has contracts with third-party payors that provide for payments to the Hospital at amounts different from its established rates. As such, gross patient revenues are reduced by contractual allowances.

A summary of the payment arrangements with major third-party payors follows:

MEDICARE

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 5 - NET PATIENT SERVICE REVENUES (CONTINUED)

MEDICARE (CONTINUED)

Services to Medicare beneficiaries are paid based on a Prospective Payment System (PPS) based on the classification of each case into a Diagnostic-Related Group (DRG). Inpatient psychiatric services are also reimbursed via a PPS system established for inpatient psychiatric patients based on pre-determined hospital specific per diems.

The Hospital is reimbursed for Direct Graduate Medical Education and Medicare Bad Debts at an interim rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's Medicare cost reports have been settled by the Medicare fiscal intermediary through fiscal year 2011 with the exception of fiscal year 2006 which remains open.

Settlements of prior year cost reports during the year ended June 30, 2016 did not have a material impact on 2016 operating results. During the year ended June 30, 2015, the Hospital received payments for filed cost report for fiscal year 2013. The Hospital recognized \$1,000,473 as a reduction of contractual allowances during the year ended June 30, 2015 related to this cost report.

MEDICAID

Inpatient services rendered to Medicaid program beneficiaries admitted prior to January 1, 2015 were reimbursed, in part, under the Tax Equity and Fiscal Responsibility Act (TEFRA) reimbursement methodology which provides for a cost-based reimbursement subject to a maximum target rate amount per discharge. Beginning January 1, 2015, Medicaid converted to an APR DRG Prospective Payment Methodology. The Hospital was reimbursed at an interim rate prior to January 1, 2015 with final settlement determined after submission of annual cost reports. Payments for inpatient services for patients admitted after January 1, 2015 will have settlement distributions for GME and Case Mix Index withholds only. Outpatient services rendered to patients are reimbursed based on the cost of services provided. The Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through 2013. Unaudited cost reports have been submitted as requested by Department of Social Services (DSS) through fiscal year 2015 with payments made through 2013 to the Hospital.

Settlements of the prior year cost reports during the year ended June 30, 2016 did not have a material impact on 2016 operating results. During the year ended June 30, 2015, the Hospital received payments for the filed cost reports for the fiscal years 2011, 2012 and 2013. The Hospital recognized \$6,661,127 as a reduction of contractual allowances during the year ended June 30, 2015, related to these cost reports.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 5 - NET PATIENT SERVICE REVENUES (CONTINUED)

COMMERCIAL INSURANCE AND MANAGED CARE

The Hospital has agreements with certain commercial insurance carriers and Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. In addition, the HMOs make fee-for-service payments to the Hospital for certain covered services based upon a discounted fee schedules.

ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS

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

- 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
- Various allowance coverage statistics

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

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 6 – ELECTRONIC HEALTH RECORD REIMBURSEMENT

The Health Information Technology for Economic and Clinical Health Act (the HITECH Act) was enacted into law on February 17, 2009 as part of the American Recovery and Reinvestment Act of 2009 (ARRA). The HITECH Act includes provisions designed to increase the use of electronic health records by health professionals and hospitals. Beginning with federal fiscal year 2011 and extending through federal fiscal year 2016, eligible providers participating in the Medicare and Medicaid programs were eligible for reimbursement incentives based on successfully demonstrating meaningful use of certified Electronic Health Record (EHR) technology. Conversely, those providers that do not successfully demonstrate meaningful use of EHR technology are subject to reductions in reimbursements beginning in fiscal year 2016.

The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology.

The Hospital utilizes a grant accounting model to recognize EHR incentive revenues. EHR incentive revenues are recognized ratably over the relevant cost report period to determine the amount of the reimbursement.

EHR incentive payment revenue totaling \$899,712 and \$1,831,037 for the years ended June 30, 2016 and 2015, respectively, was included in contract and other revenues in the accompanying statements of revenues, expenses, and changes in net position. The Hospital's attestation of compliance with the meaningful use criteria is subject to audit by the federal government. Additionally, Medicare EHR incentive payments received are subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated.

A receivable of \$373,649 was recorded for the Medicaid portion of the program as of June 30, 2015 and was included in contract and other receivables on the 2015 statement of net position. There were no such receivables recorded as of June 30, 2016.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
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NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 7 – CAPITAL ASSETS, NET

Capital assets at June 30 consist of the following:

	2016	2015
Land	\$ 183,137	\$ 183,137
Construction in progress (estimated cost to complete \$6.6 million)	24,275,272	14,702,819
Buildings	355,779,781	95,593,964
Equipment	85,711,309	69,308,916
Capital leases	11,591,634	13,776,275
	477,541,133	193,565,111
Less accumulated depreciation and amortization	145,688,175	143,073,377
Capital assets, net	\$ 331,852,958	\$ 50,491,734

Plant and equipment activity for the years ended June 30, 2016 and 2015 was as follows:

	2015	Additions	Deductions	2016
Land	\$ 183,137	\$ --	\$ --	\$ 183,137
Construction in progress	14,702,819	36,718,462	(27,146,009)	24,275,272
Buildings	95,593,964	260,824,981	(639,164)	355,779,781
Equipment	69,308,916	20,229,069	(3,826,676)	85,711,309
Capital leases	13,776,275	--	(2,184,641)	11,591,634
	\$ 193,565,111	\$ 317,772,512	\$ (33,796,490)	\$ 477,541,133
	2014	Additions	Deductions	2015
Land	\$ 183,137	\$ --	\$ --	\$ 183,137
Construction in progress	11,801,640	5,761,341	(2,860,162)	14,702,819
Buildings	93,653,262	2,768,270	(827,568)	95,593,964
Equipment	71,501,502	1,347,447	(3,540,033)	69,308,916
Capital leases	13,776,275	--	--	13,776,275
	\$ 190,915,816	\$ 9,877,058	\$ (7,227,763)	\$ 193,565,111

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 7 – CAPITAL ASSETS, NET (CONTINUED)

Related information on accumulated depreciation and amortization for the years ended June 30, 2016 and 2015 was as follows:

	2015	Additions	Deductions	2016
Buildings	\$ 74,039,138	\$ 3,324,085	\$ (355,089)	\$ 77,008,134
Equipment	55,259,571	5,586,414	(3,756,445)	57,089,540
Capital leases	<u>13,774,668</u>	<u>473</u>	<u>(2,184,640)</u>	<u>11,590,501</u>
	<u>\$ 143,073,377</u>	<u>\$ 8,910,972</u>	<u>\$ (6,296,174)</u>	<u>\$ 145,688,175</u>
	2014	Additions	Deductions	2015
Buildings	\$ 72,440,175	\$ 2,223,625	\$ (624,662)	\$ 74,039,138
Equipment	53,108,242	5,544,059	(3,392,730)	55,259,571
Capital leases	<u>13,663,308</u>	<u>111,360</u>	<u>--</u>	<u>13,774,668</u>
	<u>\$ 139,211,725</u>	<u>\$ 7,879,044</u>	<u>\$ (4,017,392)</u>	<u>\$ 143,073,377</u>

During fiscal 2016, the Hospital received transfers of capital assets from UConn Health in the amount of \$273,293,377 related to the new University Tower which was placed in service. The capital assets were transferred at the cost incurred by UConn Health which represented fair value on the date of the transfer.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 8 – LONG-TERM LIABILITIES AND OPERATING LEASES

Activity related to compensated absences for the years ended June 30, 2016 and 2015 was as follows:

	June 30, 2015 Balance	Additions	Deductions	June 30, 2016 Balance	Amounts due within 1 year
Accrued compensated absences	<u>\$ 15,624,214</u>	<u>\$ 11,808,498</u>	<u>\$ (11,774,112)</u>	<u>\$ 15,658,600</u>	<u>\$ 6,420,026</u>
	June 30, 2014 Balance	Additions	Deductions	June 30, 2015 Balance	Amounts due within 1 year
Accrued compensated absences	<u>\$ 15,082,984</u>	<u>\$ 12,220,517</u>	<u>\$ (11,679,287)</u>	<u>\$ 15,624,214</u>	<u>\$ 6,899,653</u>

The Hospital participates in operating lease agreements under UConn Health for which its departments are allocated expenses based on square footage occupied. Total rent expense for the years ended June 30, 2016 and 2015 was \$9,698,376 and \$4,665,010, respectively, which is included in internal contractual support expense and outside and other purchased services expense in the statements of revenues, expenses and changes in net position.

The Outpatient Pavilion, was substantially completed and opened in 2015, and the Hospital leases space in the facility under a sublease from UConn Health. While the sublease is expected to be renewed on an annual basis, there is no written sublease that extends beyond a one year period. UConn Health has leased the Outpatient Pavilion from the Finance Corporation under a direct financing lease that expires on March 31, 2040. The amount of rent expense that was charged to the Hospital was \$6,305,124 in 2016 and \$1,652,722 in 2015. Refer to note 10 for additional details regarding advances made by the Hospital to construct the Outpatient Pavilion.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 8 – LONG-TERM LIABILITIES AND OPERATING LEASES (CONTINUED)

The following is a schedule by year of existing future minimum lease payments under non-cancellable operating leases as of June 30, 2016, in addition to space in the Outpatient Pavilion through the sublease with UConn Health based on the assumption that the sublease will be extended annually through March 31, 2040:

<u>Year ending June 30,</u>	
2017	\$ 8,107,014
2018	8,006,885
2019	8,010,074
2020	7,964,371
2021	7,631,431
Thereafter	<u>93,175,405</u>
	<u>\$ 132,895,180</u>

NOTE 9 – PENSION PLANS

Employees of the Hospital are eligible to participate in the State Employees' Retirement System (SERS), a defined benefit pension plan, which is administered by the State Employees' Retirement Commission, the State of Connecticut Deferred Compensation Section 457 Plan (the Alternate Retirement Plan), a defined contribution plan administered by the State, or the Connecticut State Teacher's Retirement System (TRS), a defined benefit plan administered by the Teacher's Retirement Board. Information on the plans' total funding status and progress, contributions required and trend information can be found in the State of Connecticut's Comprehensive Annual Financial Report available on the State's website. Information for the SERS plan, in which the Hospital holds a significant liability under GASB 68, is presented below.

PLAN DESCRIPTION

SERS is a single-employer defined benefit Public Employees' Retirement System (PERS) established in 1939 and governed by sections 5-152 to 5-192 of the Connecticut General Statutes. Employees are covered under one of four tiers. Tier I, Tier IIA, and Tier III are contributory plans and Tier II is a non-contributory plan. Tier I Plan B participants contribute 2% or 5% of their pay, depending on their elections. Tier II Plan A and Tier III participants contribute 2% of their pay.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 9 – PENSION PLANS (CONTINUED)

Members who joined the retirement system prior to July 1, 1984 are enrolled in Tier I. Tier I employees who retire at or after age 65 with 10 years of credited service, or at or after age 55 with 25 years of service, or at age 55 with 10 years of credited service with reduced benefits are entitled to an annual retirement benefit payable monthly for life, in the amount of 2% of the annual average earnings (which are based on the three highest years of service) over \$4,800 plus 1% of \$4,800 for each year of credited service. Tier II employees who retire at or after age 60 with 25 years of service, or at age 62 with 10 years of service, or at age 70 with 5 years of service, or at age 55 with 10 years of service with reduced benefits are entitled to 1.4% times average salary at or below the breakpoint in the year of retirement, for each year of credited service. Tier III covers employees first hired on or after July 1, 2011. Tier III employees to retire at, or after age 63 with 25 years of service, or at age 65 with 10 years of service, or at age 58 with 10 years of service with reduced benefits are entitled to 1.4% times average salary at or below the breakpoint in the year of retirement, for each year of credited service.

All Tier I, Tier II, Tier IIA, and Tier III members are vested after ten years. For the June 30, 2014, actuarial valuation, there were two changes in benefit terms.

The 2011 State Employee Bargaining Agent Coalition (SEBAC) Agreement changed the benefit multiplier for the portion of the benefit below the breakpoint from 1.33% to 1.40%. This change was made effective for all active members who retire on or after July 1, 2013 in Tier II, IIA, and III, and the Hybrid Plan. A one-time decision was granted to members not eligible to retire by July 1, 2022 to elect to maintain the same normal retirement eligibility applicable to members eligible to retire before July 1, 2022. Employees who elected by July 1, 2013 to maintain their eligibility are required to make additional employee contributions for the length of their remaining active service with SERS. The additional contribution was up to 0.72% of pensionable earnings.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 9 – PENSION PLANS (CONTINUED)

CONTRIBUTIONS MADE

The Hospital's SERS contribution is determined by applying a State-mandated percentage to eligible salaries and wages. The mandated total fringe benefit rate, which includes allocations for retiree health care costs, rollforwards, and other adjustments, was 53.58%, 50.50%, and 54.71%, during fiscal years 2016, 2015, and 2014, respectively. The SERS contributions made compared to covered payroll follows:

	2016	2015	2014
Total Hospital payroll covered by SERS	\$ 52,582,554	\$ 45,714,875	\$ 34,257,752
Total Hospital SERS contributions	\$ 18,872,447	\$ 15,627,848	\$ 11,749,744
Contributions as a percentage of covered payroll	35.9%	34.2%	34.3%

PENSION LIABILITIES, PENSION EXPENSE, DEFERRED OUTFLOWS OF RESOURCES, AND DEFERRED INFLOWS OF RESOURCES

GASB 68 requires the Hospital to recognize a net pension liability for the difference between the present value of the projected benefits for past service known as the Total Pension Liability (TPL) and the restricted resources held in trust for the payment of pension benefits, known as the Fiduciary Net Position (FNP). For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, information about the fiduciary net position of SERS and additions to/deductions from SERS fiduciary net position have been determined on the same basis as they are reported by SERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit term. Investments are recorded at fair value.

At June 30, 2016 and 2015, the Hospital reported a SERS related liability of \$188.3 million and \$148.3 million, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015 and 2014, and the total pension liability used to calculate the net pension liability was determined by rolling forward the actuarial valuation performed as of June 30, 2014, based on plan experience. The Hospital's allocation of the net pension liability was based on the Hospital's percentage of total overall contributions to the SERS plan during the 2015 and 2014 fiscal years. At June 30, 2015 and 2014, the Hospital's proportion of contributions was 1.14% and .9260%, respectively.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 9 – PENSION PLANS (CONTINUED)

PENSION LIABILITIES, PENSION EXPENSE, DEFERRED OUTFLOWS OF RESOURCES, AND DEFERRED INFLOWS OF RESOURCES (CONTINUED)

For the years ended June 30, 2016 and 2015, the Hospital recognized SERS pension expense of \$19.3 million and \$12.3 million, respectively. Pension expense is reported in the Hospital's financial statements as part of fringe benefits expense.

At June 30, 2016 and 2015, the Hospital reported deferred outflows of resources and deferred inflows of resources related to SERS pension from the following sources:

	2016		2015	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
	<i>(in thousands)</i>			
Changes in proportionate allocation of pension expense	\$ 31,259	\$ --	\$ 2,596	\$ --
Hospital contributions subsequent to measurement date	18,872	--	13,358	--
Net difference between projected and actual earnings on pension plan investments	30	--	--	5,296
	\$ 50,161	\$ --	\$ 15,954	\$ 5,296

Differences between projected and actual investment earnings are amortized over a five-year, closed end period beginning in the year in which the difference occurs and will be recognized as an increase (decrease) to fringe benefits. Differences in proportionate participation are amortized over the remaining estimated service life of plan employees, estimated at 5.73 years.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 9 – PENSION PLANS (CONTINUED)

PENSION LIABILITIES, PENSION EXPENSE, DEFERRED OUTFLOWS OF RESOURCES, AND DEFERRED INFLOWS OF RESOURCES (CONTINUED)

Amortization of deferred amounts into expenses in future periods is as follows:

<u>Year ending June 30,</u>	<u>Change in proportionate participation in SERS plan</u>	<u>Net difference between projected and actual earnings on pension plan investments</u>
	<i>(in thousands)</i>	
2017	\$ 6,725	\$ (400)
2018	6,725	(400)
2019	6,725	(400)
2020	6,577	1,230
2021	4,507	--
Thereafter	--	--
	<u>\$ 31,259</u>	<u>\$ 30</u>

The amortization of the aforementioned deferred inflows and deferred outflows increased fringe benefits expense by \$338,440 during the year ended June 30, 2016, and decreased fringe benefits expense by \$1,032,131 during the year ended June 30, 2015.

ACTUARIAL METHODS AND ASSUMPTIONS

The total SERS pension liability in the June 30, 2014 actuarial valuation was determined based on the results of an actuarial experience study for the period July 1, 2007 - June 30, 2011. The key actuarial assumptions are summarized below:

Inflation:	2.75%
Salary increase:	4.00% - 20.00%, including inflation
Investment rate of return:	8.00%, net of pension plan investment expense, including inflation
Cost of living adjustment:	2.30% - 3.60% for certain tiers

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 9 – PENSION PLANS (CONTINUED)

Mortality rates were based on the RP-2000 Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements based on Scale AA.

EXPECTED RATE OF RETURN ON INVESTMENTS

The long-term expected rate of return on pension plan investments was determined using a log-normal distribution analysis in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target asset allocation and best estimate of arithmetic real rates of return for each major asset class in the SERS plan are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Large Cap U.S. Equities	21%	5.8%
Developed Non-U.S. Equities	18%	6.6%
Emerging Market (Non-U.S.)	9%	8.3%
Real Estate	7%	5.1%
Private Equity	11%	7.6%
Alternative Investments	8%	4.1%
Fixed Income (Core)	8%	1.3%
High Yield Bonds	5%	3.9%
Emerging Market Bond	4%	3.7%
TIPS	5%	1.0%
Cash	<u>4%</u>	0.4%
	<u>100%</u>	

DISCOUNT RATE

The discount rate used to measure the total SERS pension liability was the long-term expected rate of return, 8.00%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rates and that employer contributions will be made equal to the difference between the projected actuarially determined contribution and member contributions. Projected future benefit payments for all current plan members were projected through the year 2115.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 9 – PENSION PLANS (CONTINUED)

SENSITIVITY OF THE HOSPITAL'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY TO CHANGES IN THE DISCOUNT RATE

The following presents the Hospital's proportionate share of the SERS net pension liability calculated using the discount rate of 8.00%, as well as the proportionate share of the net pension liability using a 1.00% increase or decrease from the current discount rate:

	1% Decrease 7.00%	Discount Rate 8.00%	1% Increase 9.00%
Hospital's proportionate share of the net pension liability	\$ 223,949,235	\$ 188,267,185	\$ 158,205,549

TEACHERS' RETIREMENT SYSTEM

The Hospital has a limited number of participants in the Connecticut State Teachers' Retirement System.

As of June 30, 2016 and 2015, the Hospital recorded the following amounts in the financial statements related to the TRS:

	2016	2015
	<i>(in thousands)</i>	
Deferred outflows of resources	\$ 219	\$ 85
Deferred inflows of resources	--	(7)
Pension liability	90	84

ALTERNATE RETIREMENT PLAN

The Hospital also sponsors the Alternate Retirement Plan (ARP), a defined contribution plan administered through a third-party administrator, Prudential Financial, Inc. The Connecticut State Employees Retirement Commission has the authority to supervise and control the operation of the plan including the authority to make and amend rules and regulations relating to the administration of the plan.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 9 – PENSION PLANS (CONTINUED)

ALTERNATE RETIREMENT PLAN (CONTINUED)

All unclassified employees, not already in a pension plan, of a constituent unit of the state system of higher education and the central office staff of the Department of Higher Education, are eligible to participate in ARP. Participants must contribute 5% of eligible compensation each pay period while the State will contribute an amount equal to 8% of the participant's eligible compensation via a charge recouped from the Hospital.

Participant and State contributions are both 100% vested immediately. For fiscal years 2016 and 2015, charges to the Hospital for ARP were approximately \$8.4 million and \$8.0 million, respectively. The liability for fiscal years 2016 and 2015 were approximately, \$439,000 and \$417,000, respectively.

Upon separation from service, retirement, death or divorce (for alternate payee under a Qualified Domestic Relations Order), if the participant is age 55 or over and has more than 5 years of plan participation, a participant or designated beneficiary can withdraw a partial or lump cash payment, rollover to another eligible retirement plan or IRA, or receive installment payments or annuity payments. Other ARP provisions are described in Title 5 – State Employees, Chapter 66 – State Employees Retirement Act of the Connecticut General Statutes.

POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

In addition to the pension benefits, the State provides post-retirement health care and life insurance benefits to the Hospital employees in accordance with State Statutes Sections 5-257(d) and 5-259(a). When employees retire, the State may pay up to 100% of their health care insurance premium cost (including dependents' coverage) based on the plan chosen by the employee. In addition, the State pays 100% of the premium cost for a portion of the employee's life insurance continued after retirement. The amount of life insurance continued at no cost to the retiree is determined by a formula based on the number of years of State service that the retiree had at the time of retirement. Currently, the State is responsible and finances the cost of post-retirement health care and life insurance benefits on a pay-as-you-go basis through an appropriation in the General Fund; therefore, no liability is recorded in the Hospital's financial statements. However, implementation of GASB Statement No. 75, will require the recording of the Hospital's proportionate share of the net liability related to its participation in the postemployment benefit plans on the statements of net position as well as more extensive note disclosures and required supplementary information about the postemployment liabilities. This Statement is effective for fiscal years beginning after June 15, 2017.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 10 – RELATED PARTY TRANSACTIONS

The expenses reported in the statements of revenues, expenses, and changes in net position do not include undetermined amounts for salaries, services, and expenses provided to and received from UConn Health and other state agencies.

Complete allocations have not been made for salaries and other services incurred by the Hospital on behalf of other UConn Health entities. In addition, certain activities accounted for in the 21002 Fund are periodically evaluated and transferred to/from other funds depending on the overall objectives of UConn Health.

The Hospital is party to an agreement with UConn Health whereby the salaries of certain administrative employees are reimbursed by the Hospital. The non-clinical support services provided to the Hospital from UConn Health have been reported in the financial statements as internal contractual support expenses.

UConn Health transferred \$8.0 million in 2016 and 2015, related to fringe benefit recoveries for support services paid by the General Fund.

In 2016, \$273.3 million of capital assets that were recorded by UConn Health during the construction phase of the new University Tower were transferred to the Hospital. This transfer is included in transfers in the 2016 statement of revenues, expenses and changes in net position.

The Hospital's pension liability (note 9) is owed back to the State of Connecticut. The State finances this on a pay-as-you go basis through allocated retirement plan rates.

As more fully described in note 11, UConn Health charges the Hospital with an annual premium for medical malpractice costs which is determined annually by UConn Health. The Hospital is not liable beyond the annual premium, but may have future operational subsidies affected by the performance of the malpractice fund.

As described in note 1, the Hospital participates in certain State retirement plans. The State charges the Hospital for these and other fringe benefits. During the years ended June 30, 2016 and 2015, the Hospital incurred \$67,192,452 and \$57,429,802, respectively, for employee fringe benefits. Related salary costs were \$116,973,417 and \$107,310,852, respectively. The amounts due to the State related to the fringe benefit programs as of June 30, 2016 and 2015 are included in the statements of net position.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 10 – RELATED PARTY TRANSACTIONS (CONTINUED)

Contributions to the State for an assessment of postemployment benefits other than pension benefits are also included in fringe benefits expense. The related accrued postemployment benefit liability is a liability of the State. As described in note 2, GASB 75 will require the Hospital to record a liability for its proportionate share of this liability during the year ending June 30, 2018.

The Hospital provides medical services to Correctional Managed Health Care patients under a UConn Health contract with the State of Connecticut's Department of Correction (CTDOC). The Hospital provides inpatient and outpatient care to Correctional Managed Health Care patients at Medicaid rates.

The Hospital also provides certain other services under capitated contracts whereby Correctional Managed Healthcare pays a set amount per year for services regardless of volume. The Hospital recorded revenues of \$2,211,834 and \$2,123,679 for fiscal 2016 and 2015, respectively, and included these revenues in net patient services revenues in the statements of revenues, expenses, and changes in net position.

As described in note 1, Finance Corporation performs critical services on behalf of the Hospital. These services include the acquisition, construction, and maintenance of clinical space such as the new Outpatient Pavilion building. Total amounts advanced to the Finance Corporation were \$14,738,906 and \$14,745,906 at June 30, 2016 and 2015, respectively.

During the year ended June 30, 2015, \$2.0 million was returned to the Hospital by Finance Corporation as part of the overall plan to refund advanced amounts. The Hospital has received a financial guarantee from UConn Health that it will provide the funding required for Finance Corporation to repay the \$14.7 million of advances if required. Amounts advanced for construction of the Outpatient Pavilion are expected to be returned after the completion of construction.

NOTE 11 – REPORTING OF THE MALPRACTICE FUND

UConn Health is self-insured with respect to medical malpractice risks. Estimated losses from asserted and unasserted claims identified under UConn Health's incident reporting system and an estimate of incurred but not reported claims are accrued based on actuarially determined estimates that incorporate UConn Health's past experience as well as other considerations, including the nature of each claim or incident and relevant trend factors. The Hospital provides timely incident reporting to UConn Health to assist UConn Health in maintaining appropriate reserve balances.

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

NOTE 11 – REPORTING OF THE MALPRACTICE FUND (CONTINUED)

To the extent that claims for cases exceed current year premiums charged by UConn Health, UConn Health may petition the State to make up the difference. The Hospital is not responsible for amounts beyond the annual premium allocated by UConn Health. However, operational subsidies from the State and/or UConn Health may be affected by the performance of UConn Health's malpractice program.

At June 30, 2016 and 2015, UConn Health's Malpractice Fund had actuarial reserves of approximately \$31.6 million and \$26.8 million and assets of approximately \$9.4 million and \$10.1 million, respectively.

NOTE 12 – SUBSEQUENT EVENTS

The Hospital has evaluated subsequent events through October 31, 2016, which represents the date the financial statements were available to be issued and noted no subsequent events that would have impacted the Hospital's financial statements.



**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Joint Audit and Compliance Committee
University of Connecticut Health Center

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the University of Connecticut Health Center John Dempsey Hospital (21002 Fund) (the Hospital), which comprise the statement of net position as of June 30, 2016 and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 31, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Hospital's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Hospital's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Marcum LLP

Hartford, CT
October 31, 2016

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

**SCHEDULES OF REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF CHANGES IN JOHN DEMPSEY HOSPITAL'S
NET PENSION LIABILITY AND RELATED RATIOS –
STATE EMPLOYEES' RETIREMENT SYSTEM ONLY**

	2015	2014
	<i>(dollars in thousands)</i>	
Total Pension Liability		
Service cost	\$ 3,537	\$ 2,662
Interest	23,387	18,508
Benefit payments, including refunds of member contributions	(18,886)	(14,510)
Change in proportionate allocation of pension liability	56,513	--
Net Change in Total Pension Liability	64,551	6,660
Total Pension Liability - Beginning	245,266	238,606
Total Pension Liability - Ending (a)	<u>\$ 309,817</u>	<u>\$ 245,266</u>
Fiduciary Net Position		
Contributions - employer	\$ 15,628	\$ 11,750
Contributions - employee	2,133	1,341
Net investment income	3,354	13,366
Benefit payments, including refunds of member contributions	(18,886)	(14,510)
Change in proportionate allocation of fiduciary net position	22,343	--
Net Change in Fiduciary Net Position	24,572	11,947
Fiduciary Net Position - Beginning	96,976	85,029
Fiduciary Net Position - Ending (b)	<u>\$ 121,548</u>	<u>\$ 96,976</u>
Hospital's Net Pension Liability - Ending (a)-(b)	<u>\$ 188,269</u>	<u>\$ 148,290</u>
Hospital's Portion of SERS Net Pension Liability	1.13935%	0.92599%
Fiduciary Net Position as a Percentage of the Total Pension Liability	39.23%	39.54%
Hospital's Covered-Employee Payroll	\$ 45,715	\$ 34,258
Hospital's Net Pension Liability as a Percentage of Covered-Employee Payroll	411.83%	432.86%

**UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)**

**SCHEDULES OF REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF PENSION CONTRIBUTIONS TO THE
STATE EMPLOYEES' RETIREMENT SYSTEM**

	2016	2015	2014	2013	2012	2011	2010
	<i>(dollars in thousands)</i>						
Contractually required	\$ 18,872	\$ 15,714	\$ 11,750	\$ 9,812	\$ 8,578	\$ 8,742	\$ 8,310
Contributions in relation to the contractually required contribution	<u>18,872</u>	<u>15,628</u>	<u>11,750</u>	<u>9,798</u>	<u>8,578</u>	<u>7,647</u>	<u>6,672</u>
Contribution deficiency	\$ --	\$ 86	\$ --	\$ 14	\$ --	\$ 1,095	\$ 1,638
Hospital's covered-employee payroll	\$ 52,583	\$ 45,715	\$ 34,258	\$ 30,600	\$ 29,722	\$ 30,636	\$ 27,045
Contributions as a percentage of covered-employee payroll	35.90%	34.19%	34.30%	32.02%	28.86%	24.96%	24.67%