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Audited Consolidated Financial Statements and Supplementary Information

MidState Medical Center and Subsidiaries
Years Ended September 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

Ernst & Young

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Audited Consolidated Financial Statements
and Supplementary Information

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Contents

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Report of Independent Auditors

Board of Directors
MidState Medical Center

We have audited the accompanying consolidated balance sheets of MidState Medical Center and subsidiaries (collectively referred to as the Medical Center) as of September 30, 2012 and 2011, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Medical Center's management. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Medical Center's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting.

Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Medical Center as of September 30, 2012 and 2011, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the accompanying consolidated financial statements, in 2012 the Medical Center changed its method of reporting estimated insurance claims receivable and estimated insurance claims liabilities with the adoption of the Accounting Standards Update No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*.

Ernst + Young LLP

January 25, 2013

MidState Medical Center and Subsidiaries

Consolidated Balance Sheets

	September 30 2012	September 30 2011
Assets		
Current assets:		
Cash and cash equivalents	**$ 47,972,840**	$ 20,898,243
Accounts receivable, less allowances for doubtful accounts of approximately $8,764,000 in 2012 and $7,773,000 in 2011	**25,147,640**	23,676,854
Other receivables	**9,036,167**	7,320,922
Due from affiliated entities	**6,319,474**	–
Inventories of supplies	**2,649,756**	1,896,399
Prepaid expenses and other assets	**2,789,213**	2,626,149
Total current assets	**93,915,090**	56,418,567
Assets whose use is limited:		
Board-designated investments	**13,032,246**	10,835,261
Donor restricted investments	**1,887,592**	1,666,292
Funds designated for debt service	**6,312,325**	6,312,325
	21,232,163	18,813,878
Funds held in trust by others	**13,223,292**	11,682,166
Other assets	**37,032,492**	28,217,035
Property, plant and equipment, net	**127,788,769**	132,230,436
	$ 293,191,806	$ 247,362,082

	September 30	
	2012	**2011**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 5,495,874**	$ 3,977,777
Salaries, wages, and amounts withheld from employee compensation	**10,062,117**	9,084,845
Estimated third-party payor settlements	**3,562,417**	1,800,530
Accrued expenses	**6,395,189**	511,787
Current portion of accrued pension liability	**2,429,187**	2,262,107
Current portion of other liabilities	**2,236,550**	2,664,000
Total current liabilities	**30,181,334**	20,301,046
Accrued pension liability	**56,785,518**	57,749,335
Other liabilities	**26,866,681**	8,153,783
Long-term debt	**88,731,315**	88,754,643
Net assets:		
Unrestricted	**74,346,080**	57,976,004
Temporarily restricted	**2,279,087**	1,966,917
Permanently restricted	**14,001,791**	12,460,354
	90,626,958	72,403,275
	$ 293,191,806	$ 247,362,082

See accompanying notes .

MidState Medical Center and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended September 30	
	2012	**2011**
Unrestricted revenues, gains, and other support:		
Net patient service revenue	**$ 218,353,748**	$ 196,755,436
Provision for bad debts *(see Note 1)*	**6,461,499**	7,875,420
Net patient service revenue less provision of bad debts	**211,892,249**	188,880,016
Other operating revenue	**41,887,116**	27,159,567
Net assets released from restrictions for operations	**327,257**	241,164
	254,106,622	216,280,747
Operating expenses:		
Salaries	**78,095,938**	74,803,914
Employee benefits	**28,749,594**	26,868,042
Supplies and other	**47,278,944**	32,753,811
Purchased services	**57,850,845**	57,698,523
Provision for non-patient bad debts	**8,498,226**	425,000
Depreciation and amortization	**13,214,810**	13,144,617
Interest	**3,996,300**	2,222,925
	237,684,657	207,916,832
Income from operations before loss on early extinguishment of debt	**16,421,965**	**8,363,915**
Loss on early extinguishment of debt	**–**	(925,377)
Income from operations	**16,421,965**	7,438,538
Non-operating income (loss):		
Income from investments, gifts and bequests, net	**1,448,167**	1,172,782
Loss on interest rate swap	**(1,587,712)**	(106,639)
	(139,545)	1,066,143
Excess of revenues over expenses before change in unrealized gains and losses on investments	**16,282,420**	8,504,681
Change in unrealized gains and losses on investments	**1,362,036**	(610,653)
Excess of revenues over expenses	**17,644,456**	7,894,028

Continued on next page.

MidState Medical Center and Subsidiaries

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

	Year Ended September 30	
	2012	**2011**
Unrestricted net assets:		
Excess of revenues over expenses (continued)	**$ 17,644,456**	$ 7,894,028
Net assets released from restrictions for purchase of property and equipment	**225,425**	228,245
Change in funded status of pension plan	**(1,499,494)**	(12,286,285)
Transfer to permanently restricted net assets	**(311)**	(625)
Increase (decrease) in unrestricted net assets	**16,370,076**	(4,164,637)
Temporarily restricted net assets:		
Change in unrealized gains and losses on investments	**220,990**	(99,078)
Income from investments	**213**	246
Income from special purpose funds	**82,448**	82,463
Net assets released from restrictions for purchase of property and equipment	**(225,425)**	(228,245)
Net assets released from restrictions for operations	**(327,257)**	(241,164)
Bequests, gifts and grants	**509,977**	447,834
Pledge contributions	**51,224**	42,677
Increase in temporarily restricted net assets	**312,170**	4,733
Permanently restricted net assets:		
Transfer from unrestricted net assets	**311**	625
Change in unrealized gains and losses on funds held in trust by others	**1,541,126**	(513,144)
Increase (decrease) in permanently restricted net assets	**1,541,437**	(512,519)
Increase (decrease) in net assets	**18,223,683**	(4,672,423)
Net assets at beginning of year	**72,403,275**	77,075,698
Net assets at end of year	**$ 90,626,958**	$ 72,403,275

See accompanying notes.

MidState Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended September 30 2012	2011
Cash flows from operating activities and other income		
Change in net assets	**$ 18,223,683**	$ (4,672,423)
Adjustments to reconcile change in net assets to net cash provided by operating activities and other income:		
Noncash items:		
Depreciation and amortization	**13,214,810**	13,144,617
Change in unrealized gains and losses on investments	**(1,583,026)**	709,731
Change in fair value of interest rate swaps	**757,915**	(102,896)
Change in funded status of pension plan	**1,499,494**	12,286,285
Change in unrealized gains and losses on funds held in trust by others	**(1,541,126)**	513,144
Provision for patient bad debts	**6,461,499**	7,875,420
Provision for non-patient bad debts	**8,498,226**	425,000
Loss on early extinguishment of debt	**–**	925,377
Other changes in net assets:		
Restricted contributions and investment income	**(643,862)**	(573,220)
Changes in operating assets and liabilities, net *(Note 12)*	**(8,825,147)**	(28,488,520)
Net cash provided by operating activities and other income	**36,062,466**	2,042,515
Cash flows from investing activities		
Purchases of property, plant and equipment, net	**(8,773,144)**	(10,580,677)
Increase in assets whose use is limited, net	**(835,259)**	(5,408,293)
Net cash used in investing activities	**(9,608,403)**	(15,988,970)
Cash flows from financing activities		
Proceeds of issuance of bonds, net of change in issuance costs	**–**	87,615,988
Principal payments on long-term debt	**(23,328)**	(82,915,000)
Restricted contributions and investment income	**643,862**	573,220
Net cash provided by financing activities	**620,534**	5,274,208
Increase (decrease) in cash and cash equivalents	**27,074,597**	(8,672,247)
Cash and cash equivalents at beginning of year	**20,898,243**	29,570,490
Cash and cash equivalents at end of year	**$ 47,972,840**	$ 20,898,243

See accompanying notes.

1. Significant Accounting Policies

The accounting policies that affect significant elements of the MidState Medical Center and its Subsidiaries' (collectively referred to as the Medical Center), consolidated financial statements are summarized below.

Organization

The Medical Center is a nonprofit organization incorporated under the General Statutes of the State of Connecticut. Hartford HealthCare Corporation (HHC) is the sole member of the Medical Center. The Board of HHC elects the Board of Directors and officers of the Medical Center who manage its property and affairs.

In fiscal year 1999, the Medical Center acquired an 80% interest in Meriden Imaging Center (the Center) and began consolidating its financial statements.

Effective February 14, 2006, MidState MSO, LLC (a wholly-owned subsidiary of the Medical Center) was created to provide management services and support for medical practices.

All material intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from estimates.

Regulatory Matters

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

1. Significant Accounting Policies (continued)

Fair Values

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value. The fair value of the Medical Center's financial instruments is disclosed in Note 4.

Cash and Cash Equivalents

Cash and cash equivalents include cash and certificates of deposit which are available to be converted to liquid assets within three months. Cash and cash equivalents are maintained with domestic financial institutions with deposits that exceed federally insured limits. It is the Medical Center's policy to monitor the financial strength of these institutions.

Patient Accounts Receivable

Patient accounts receivable result from the health care services provided by the Medical Center. Additions to the allowance for doubtful accounts result from the provision for bad debts. Accounts written off as uncollectible are deducted from the allowance for doubtful accounts.

The amount of the allowance for doubtful accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in Medicare and Medicaid health care coverage and other collection indicators. See Note 2 for additional information relative to third-party payer programs.

The Medical Center's primary concentration of credit risk is patient accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies and private patients. The Medical Center manages the receivables by regularly reviewing its patient accounts and contracts and by providing appropriate allowance for doubtful amounts. Significant concentrations of accounts receivable for services to patients include 36% from Medicare, 13% from Medicaid, 30% from commercial insurance carriers and 21% from others at September 30, 2012 (41%, 16%, 26% and 17%, respectively, at September 30, 2011).

Investments

The Medical Center's investment portfolio is classified as trading, with unrealized gains and losses included in the excess of revenues over expenses.

1. Significant Accounting Policies (continued)

Investments in equity securities with determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations at the balance sheet date. Assets temporarily restricted (by donor) are recorded at fair value at the date of donation, which is then considered cost. Investment income (including realized gains and losses, interest and dividends, and the change in unrealized gains and losses) is included in nonoperating income unless the income or loss is restricted by the donor or law. The cost of securities sold is based on the specific identification method.

Inventories

Inventories are stated at the lower of cost or market. The Medical Center values its inventories using the first-in, first-out method.

Property, Plant and Equipment

Property, plant and equipment are stated on the basis of cost. The Medical Center provides for depreciation of property, plant and equipment using the straight-line method in amounts sufficient to depreciate the cost of the assets over their estimated useful lives.

Interest Rate Swap Agreements

The Medical Center utilizes interest rate swap agreements to reduce risks associated with changes in interest rates. The Medical Center does not hold or issue derivative financial instruments for trading purposes. The Medical Center is exposed to credit loss in the event of nonperformance by the counterparties to its interest rate swap agreements.

Interest rate swap agreements are reported at fair value. Changes in fair value are recognized in the performance indicator in the statements of operations and changes in net assets.

Assets Whose Use is Limited

Assets whose use is limited includes assets that are set aside by the Board of Directors for future capital improvements, health care services based on donor's intent and debt service funds for existing obligations on outstanding long-term debt.

1. Significant Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time frame or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Medical Center in perpetuity. The Medical Center is a partial beneficiary to various perpetual trust agreements. Assets recorded under these agreements are recognized at fair value. The investment income generated from these trusts is expendable to support healthcare services and the assets are classified as permanently restricted.

Contributions, including unconditional promises to give, are recognized as revenue in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Unrestricted contributions are recorded net of expenses within operating revenue.

Pledges receivable to be received after one year are discounted at a rate commensurate with the risks involved. Amortization of the discount is recognized as revenue and is reflected in accordance with donor-imposed restrictions, if any.

Donor Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets, as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are unrestricted contributions in the accompanying financial statements except for contributions of long-lived assets.

Bond Issuance Costs

Bond issuance costs associated with long-term debt for capital projects are amortized over the term of the debt using a method that approximates the effective interest method. Bond issuance costs of $1,742,044 and $1,819,787 are recorded in other assets in the consolidated balance sheets at September 30, 2012 and 2011, respectively.

1. Significant Accounting Policies (continued)

Other Operating Revenue

Other operating revenue includes revenue from service to others, electronic health record incentive program revenue, equity earnings of CHS Insurance Limited, rental income, and the change in the investment in the captive insurance company.

Nonoperating Income

Nonoperating income primarily consists of income on invested funds, realized and unrealized gains and losses on invested funds, and loss on the interest swap agreement.

Excess of Revenues over Expenses

The consolidated statements of operations and changes in net assets include the excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from the excess revenues over expenses, include the changes in the pension funded obligation, net assets released from restrictions for the purchase of equipment, and permanent transfers of assets to and from affiliates.

Medical Malpractice Insurance

Coverage for medical malpractice insurance is provided on a claims-made basis. The primary level of coverage is $10,000,000 per claim and $39,000,000 in the aggregate. The excess indemnity coverage is layered with four different insurance companies at $15,000,000 per claim and $15,000,000 in the aggregate per layer and is reinsured through the captive. The primary coverage is with CHS Insurance Limited, a captive insurance company in which the Medical Center has a 25% ownership interest. The Medical Center's ownership is accounted for under the equity method and is included in other assets in the accompanying consolidated balance sheets. The investment activity of CHS Insurance Limited is included in other operating revenue within the accompanying consolidated statement of operations and changes in net assets, and was $17,840,000 and $7,257,000 for the years ended September 30, 2012 and 2011, respectively. The incurred-but-not-reported liability was $3,385,000 and $4,164,000 at September 30, 2012 and 2011, respectively, which is discounted at 2.49%

1. Significant Accounting Policies (continued)

Income Taxes

The Medical Center is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Center is an S Corporation, a pass-through entity not subject to federal income taxes. MidState MSO is a single member limited liability company treated as part of its sole member for federal tax purposes.

Electronic Health Record Incentive Program

The Centers for Medicare & Medicaid Services (CMS) have implemented provisions of the American Recovery and Reinvestment Act of 2009 that provides incentive payments for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The Medicare EHR incentive program provides annual incentive payments to eligible professionals, eligible hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. 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 Medical Center 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 reimbursement. Accordingly, the Medical Center recognized $2,417,477 of EHR revenues during the year ended September 30, 2012, approximately $1,754,215 and $663,262 relating to Medicare and Medicaid, respectively. EHR incentive revenues are included in other operating revenues in the accompanying consolidated statements of operations and changes in net assets.

The Medical Center's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, Medicare EHR incentive payments received are subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated.

1. Significant Accounting Policies (continued)

New Accounting Pronouncements

In August 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Recoveries* (ASU 2010-24), which provides clarification to companies in the health care industry on the accounting for professional liability and similar insurance. ASU 2010-24 states that insurance liabilities should not be presented net of insurance recoveries and that an insurance receivable should be recognized on the same basis as the liabilities, subject to the need for a valuation allowance for uncollectible accounts. ASU 2010-24 is effective for fiscal years beginning after December 15, 2010 and was adopted by the Medical Center on October 1, 2011. The adoption of this standard increased other current assets and other current liabilities by approximately \$6.0 million, and other assets and other long-term liabilities by approximately \$18.3 million in the consolidated balance sheet as of September 30, 2012 as compared to September 30, 2011.

In July 2011, FASB issued ASU 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts* (ASU 2011-07). The provisions of ASU 2011-07 require certain health care entities to present the provision for bad debts associated with patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) rather than as an operating expense. Additional disclosures relating to sources of patient service revenue and the allowance for doubtful accounts will also be required. The guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011, with early adoption permitted. The Medical Center adopted those provisions as of and for the year ended September 30, 2012 and retrospectively applied the presentation requirements to all periods presented. See Note 1 and Note 2 for additional disclosures required by ASU 2011-07. There was no material impact to the Medical Center's consolidated financial statements aside from the required changes in presentation.

In August 2010, the FASB issued ASU 2010-23, *Measuring Charity Care for Disclosure* (ASU 2010-23). ASU 2010-23 requires that the level of charity care provided be presented based on the direct and indirect costs of the charity services provided. ASU 2010-23 also requires separate disclosure of the amount of any cash reimbursements received for providing charity care. ASU 2010-23 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The Medical Center adopted this guidance in 2012 which had no material impact to the consolidated financial statements. Refer to Note 2 for the related disclosures.

1. Significant Accounting Policies (continued)

Reclassifications

Certain reclassifications have been made to the year ended September 30, 2011 balances previously reported in the consolidated balance sheets and statements of operations and changes in net assets in order to conform with the year ended September 30, 2012 presentation. For the year ended September 30, 2011, the Meriden Imaging and the MSO accounts receivable was reclassified from accounts receivable, net to other receivables in the amount of $5,904,893. In addition, the provision for allowance for bad debts was moved to net revenue from operating expenses.

2. Revenue from Services to Patients, Charity Care and Accounts Receivable

Revenues from the Medicare and Medicaid programs accounted for approximately and 37% and 11% and 36% and 11%, of the Medical Center's net patient services the years ended September 30, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

The Medical Center believes that it is in compliance with all applicable laws and regulations, and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Medical Center.

2. Revenue from Services to Patients, Charity Care and Accounts Receivable (continued)

The following table summarizes net revenue from services to patients:

	Year Ended September 30	
	2012	**2011**
Gross revenues from patients:		
Inpatients	**$ 212,045,748**	$ 204,208,669
Outpatients	**267,599,887**	219,207,273
	479,645,635	423,415,942
Deductions:		
Allowances	**257,058,291**	223,635,468
Charity Care	**4,233,596**	3,025,038
	261,291,887	226,660,506
Net patient service revenue	**218,353,748**	196,755,436
Provision for bad debts	**6,461,499**	7,875,420
Net patient service revenue less provision for bad debts	**$ 211,892,249**	$ 188,880,016

The Medical Center has agreements with third-party payers that provide for payments to the Medical Center at amounts different from its established rates. The difference is accounted for as allowances. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, fee-for-service, and discounted charges and per diem payments. Net patient service revenue is affected by the State of Connecticut Disproportionate Share program and is reported at the estimated net realizable amounts due from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations. The Medical Center recorded net changes in estimates of approximately $3.1 million and $2.2 million related to better than previously estimated third-party payer settlements at September 30, 2012 and 2011, respectively.

2. Revenue from Services to Patients, Charity Care and Accounts Receivable (continued)

The Medical Center has established estimates based on information presently available, of amounts due to or from Medicare, Medicaid and third-party payers for adjustments to current and prior year payment rates, based on industry-wide and Medical Center-specific data. Such amounts are included in the accompanying balance sheets. Additionally, certain payers' payment rates for various years have been appealed by the Hospital. If the appeals are successful, additional income applicable to those years might be realized.

The Medical Center has agreements with various health maintenance organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, the HMOs make fee-for-service payments to the Medical Center for certain covered services based upon discounted fee schedules.

The Hospital's estimation of the allowance for doubtful 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 Company'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 doubtful accounts.

2. Revenue from Services to Patients, Charity Care and Accounts Receivable (continued)

The Medical Center accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to the established policies of the Medical Center. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Medical Center utilizes the generally recognized poverty income levels for the State of Connecticut, but also includes certain cases where incurred charges are significant when compared to incomes.

The Hospital provides services without charge or at amounts less than its established rates, to patients who meet the criteria of its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such services are not reported as revenue. For patients who were determined by the Hospital to have the ability to pay but did not, the uncollected amounts are recorded as bad debt expense. In distinguishing charity care from bad debt expense, a number of factors are considered, certain of which require a high degree of judgment.

The estimated cost of charity care provided was $1,792,275 and $1,406,678 for the years ended September 30, 2012 and 2011, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

Patient service revenue, net of contractual allowances and before the provision for bad debts, recognized in the period from major payor sources for the year ended September 30, 2012, is as follows:

Medicare	36
Medicaid	14
Self pay	5
All other	45
	100%

3. Assets Whose Use is Limited

Included in assets whose use is limited at September 30 are the following:

	2012	2011
Cash and cash equivalents	**$ 390,727**	$ 115,438
Money market funds	**6,312,325**	6,312,325
Domestic equity securities	**7,465,517**	5,587,167
Domestic fixed income securities	**2,570,999**	2,404,624
Mutual Funds:		
U.S.	**3,004,687**	2,897,124
International	**1,255,708**	1,265,000
Other	**232,200**	232,200
	$ 21,232,163	$ 18,813,878

The composition and presentation of income from investments, gifts, and bequests in non-operating income in the consolidated statements of operations and changes in net assets, are as follows:

	Year Ended September 30	
	2012	2011
Interest and dividend income	**$ 92,372**	$ 377,675
Income from endowments	**1,355,795**	795,107
	$ 1,448,167	$ 1,172,782

4. Fair Values of Financial Instruments

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

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

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

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

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, the Medical Center utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers nonperformance risk in its assessment of fair value.

4. Fair Values of Financial Instruments (continued)

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

	September 30, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Cash and cash equivalents	$ 47,972,840	$ –	$ –	$ 47,972,840
Assets limited as to use:				
Cash and cash equivalents	390,727	–	–	390,727
Money market funds	6,312,325	–	–	6,312,325
Domestic equity securities	7,465,517	–	–	7,465,517
Domestic fixed income bonds	–	2,570,999	–	2,570,999
Mutual funds:				
U.S.	3,004,687	–	–	3,004,687
International	1,255,708	–	–	1,255,708
Other	–	232,200	–	232,200
Funds held in trust by others	–	13,223,292	–	13,223,292
Liabilities				
Interest rate swap agreements	–	6,478,759	–	6,478,759

4. Fair Values of Financial Instruments (continued)

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

	September 30, 2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Cash and cash equivalents	$ 20,898,243	$ –	$ –	$ 20,898,243
Assets limited as to use:				
Cash and cash equivalents	115,438	–	–	115,438
Money market funds	6,312,325	–	–	6,312,325
Domestic equity securities	5,587,167	–	–	5,587,167
Domestic fixed income bonds	–	2,404,624	–	2,404,624
Mutual funds:				
U.S.	2,897,124	–	–	2,897,124
International	1,265,000	–	–	1,265,000
Other	–	232,200	–	232,200
Funds held in trust by others	–	11,682,166	–	11,682,166
Other assets:				
Cash and cash equivalents	250,000	–	–	250,000
Money market funds	–	250,107	–	250,107
Liabilities				
Interest rate swap agreements	–	5,720,844	–	5,720,844

Financial assets carried at fair value included in the cash balance retirement plan as of September 30, 2012 are held in a master trust. The Medical Center owns participant units in the trust which was established on May 1, 2012. Financial assets classified within the trust are 43.3% Level 1, 45.4% Level 2 and 11.3% Level 3.

4. Fair Values of Financial Instruments (continued)

Financial assets carried at fair value in the defined benefit pension plan are classified in the table below in one of the three categories described above:

	September 30, 2011			
	Level 1	Level 2	Level 3	Total
Pension plan assets:				
Money market funds	$ 631,651	$ –	$ –	$ 631,651
Mutual funds:				
U.S.	20,811,251	–	–	20,811,251
International	8,848,087	–	–	8,848,087
Common collective funds:				
U.S.	–	57,993,541	–	57,993,541
International	–	4,815,217	–	4,815,217
Other	–	9,000,000	–	9,000,000

Fair value for Level 1 assets is based upon quoted market prices. Fair value for Level 2 assets is based upon model-based valuations techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers and brokers. The interest rate swap agreement is valued based on a determination of market expectations related to the future cash flows associated with the swap contract using sophisticated modeling based on observable market based inputs, such as interest rate curves.

5. Net Assets

Temporarily restricted net assets are primarily available for the purchase of equipment and for health care services. Permanently restricted net assets included permanently restricted gifts and funds held in trust.

The Medical Center's endowment consists of approximately 100 individuals funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments are classified and reported based on the existence or absence of donor-imposed restrictions.

5. Net Assets (continued)

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

1) The duration and preservation of the fund

2) The purposes of the Medical Center and the donor-restricted endowment fund

3) The general economic conditions

4) The possible effect of inflation and deflation

5) The expected total return from income and the appreciation of investments

6) The other resources of the Medical Center

7) The investment policies of the Medical Center

The Medical Center has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Medical Center must hold in perpetuity or for a donor-specific period(s). Under the policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce a real return, net of inflation and investment management costs, of at least 4% over the long term. Actual returns in any given year may vary from this amount.

5. Net Assets (continued)

To satisfy its long-term rate-of-return objectives, the Medical Center relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Medical Center targets a diversified asset allocation that places a greater emphasis on equity-based alternative investments to achieve its long-term objective within prudent risk constraints.

The Medical Center's spending policy is that investment income and realized and unrealized gains and losses associated with the endowments are appropriated for spending. This is consistent with the Medical Center's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment returns.

Endowment net asset composition by type of fund as of September 30, 2012, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds		$ 1,109,093	$ 778,499	$ 1,887,592
Board-designated endowment funds	$ 13,032,246	–	–	13,032,246
	$ 13,032,246	$ 1,109,093	$ 778,499	$ 14,919,838

5. Net Assets (continued)

Changes in endowment funds for the fiscal year ended September 30, 2012, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at beginning of year	$ 10,835,261	$ 888,104	$ 778,188	$ 12,501,553
Net asset reclassifications	(311)	–	311	–
Endowment net assets after reclassification	10,834,950	888,104	778,499	12,501,553
Investment return:				
Investment income	357,444	–	–	357,444
Net appreciation (realized and unrealized)	1,958,810	220,989	–	2,179,799
Total investment return	2,316,254	220,989	–	2,537,243
Appropriation of endowment assets for expenditure	(118,958)	–	–	(118,958)
	$ 13,032,246	$ 1,109,093	$ 778,499	$ 14,919,838

Endowment net asset composition by type of fund as of September 30, 2011, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds		$ 888,104	$ 778,188	$ 1,666,292
Board-designated endowment funds	$ 10,835,261	–	–	10,835,261
	$ 10,835,261	$ 888,104	$ 778,188	$ 12,501,553

5. Net Assets (continued)

Changes in endowment funds for the fiscal year ended September 30, 2011, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at beginning of year	$ 11,182,066	$ 987,182	$ 777,563	$ 12,946,811
Net asset reclassifications	(625)	–	625	–
Endowment net assets after reclassification	$ 11,181,441	$ 987,182	$ 778,188	$ 12,946,811
Investment return:				
Investment income	$ 365,655	$ –	$ –	$ 365,655
Net depreciation (realized and unrealized)	(597,200)	(99,078)		(696,278)
Total investment return	(231,545)	(99,078)	–	(330,623)
Appropriation of endowment assets for expenditure	(114,635)	–	–	(114,635)
Endowment net assets at end of year	$ 10,835,261	$ 888,104	$ 778,188	$ 12,501,553

From time to time, the fair value of assets associated with individual donor-restricted endowments funds may fall below the level that the donor of UPMIFA requires the Medical Center to retain as a fund of perpetual duration. These deficiencies result from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that were deemed prudent by the Board of Directors. There were no deficiencies of this nature which are reported in unrestricted net assets as of September 30, 2012 or 2011.

6. Property, Plant and Equipment

Property, plant and equipment consist of the following at September 30:

	2012	2011
Land and land improvements	**$ 9,533,536**	$ 9,533,537
Buildings and building improvements	**114,596,821**	114,582,620
Equipment	**128,867,777**	121,524,563
Construction in process (estimated cost to complete $1,237,000)	**1,631,461**	338,221
	254,629,595	245,978,941
Accumulated depreciation	**(126,840,826)**	(113,748,505)
	$ 127,788,769	$ 132,230,436

7. Pension Plan

The Medical Center has a defined benefit pension plan, covering substantially all of its employees and executives, and a noncontributory, supplemental defined-benefit retirement plan for certain executive employees (collectively, the pension plans). The benefits are based on years of service and the employees' compensation during the last five years of employment. The Medical Center makes contributions in amounts sufficient to fund the Plan's current service cost and to fund the past service costs plus interest thereon over a period of approximately 30 years. An accrued pension liability is included in the accompanying balance sheets related to the pension plans. The Medical Center also has a nonqualified pension plan covering substantially all of its employees and executives.

7. Pension Plan (continued)

The following table sets forth the Plan's funded status and amounts recognized in the Medical Center's consolidated balance sheets:

	September 30	
	2012	**2011**
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 159,849,082**	$ 146,595,384
Service cost	**3,747,666**	3,567,057
Interest cost	**8,188,049**	8,070,842
Net benefits payments and transfers	**(4,920,982)**	(3,839,127)
Amendments	**23,836**	–
Curtailments	**(11,786,867)**	–
Actuarial gain	**27,211,137**	5,454,926
	$ 182,311,921	$ 159,849,082
Change in plan assets		
Fair value of plan assets at beginning of year	**$ 102,099,747**	$ 94,507,611
Actual return on plan assets	**19,647,638**	(1,868,737)
Employer contribution	**8,700,000**	13,300,000
Net benefit payments and transfers	**(4,920,982)**	(3,839,127)
Fair value of plan assets at end of year	**125,526,403**	102,099,747
Underfunded status of the plan	**$ (56,785,518)**	$ (57,749,335)
Components of net periodic benefit cost		
Service cost	**$ 3,747,666**	$ 3,567,057
Interest cost	**8,188,049**	8,070,842
Expected return on plan assets	**(9,131,984)**	(8,157,939)
Net amortization and deferral	**4,317,914**	3,195,317
Curtailment gain	**(884,957)**	–
Net periodic benefit cost	**$ 6,236,688**	$ 6,675,277

The accumulated benefit obligation for the pension plans was $181,652,205 and $147,749,024 at, September 30, 2012 and 2011, respectively.

7. Pension Plan (continued)

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

Included in unrestricted net assets at September 30, 2012 and 2011, respectively, are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service cost (credit) of $23,836 and ($952,588) and unrecognized actuarial loss of $67,818,414 and $67,295,344. The prior service cost and actuarial loss included in unrestricted net assets and expected to be recognized in net periodic pension cost during the year ending September 30, 2013 is $5,879,917.

Plan Assets

The Plan's investment objectives are to achieve long-term growth in excess of long-term inflation and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets over a long-term time horizon. In order to minimize the risk, the Plan aims to minimize the variability in yearly returns. The Plan also aims to diversify its holding among sectors, industries, and companies. No more than 5% of the plan's portfolio (excluding U.S. government securities and cash) may be held in an individual company's stocks or bonds.

The Medical Center's pension plan weighted-average allocations at September 30, 2012 and 2011, by asset category are as follows:

Asset Category	Target Allocation	2012	2011
Equity securities	**57%**	**41%**	65%
Fixed income/debt securities	**25%**	**14%**	34%
Commodities/inflation/real assets	**8%**	**34%**	–
Other	**10%**	**11%**	1%

Contributions

The Medical Center estimates fiscal year 2013 plan contributions of $6,587,000.

7. Pension Plan (continued)

The Medical Center's Board of Directors adopted a resolution to freeze the Plan for non-union employees effective December 31, 2012. As a result of this resolution, the plan's liability was re-measured for non-union employees as of May 31, 2012. All outstanding prior service credits related to these employees totaling, $884,957 was recognized as a curtailment gain of the date of re-measurement. This amount was included in employee benefits within the consolidated statement of operations and changes in nets assets for the year ended September 30, 2012.

Estimated Future Benefit Payments

Benefit payments are expected to be paid as follows:

Fiscal Year	Pension Benefits
2013	$ 5,545,948
2014	9,098,018
2015	6,814,159
2016	7,439,460
2017	8,067,335
Years 2018 - 2022	48,323,425

Assumptions

The weighted-average assumptions used to determine projected benefit obligations are as follows:

	September 30 2012	2011
Discount rate	**4.05%**	5.25%
Rate of increase in compensation	**3.50%**	3.50%

7. Pension Plan (continued)

The weighted-average assumptions used to determine net periodic benefit cost are as follows:

	September 30	
	2012	**2011**
Discount rate	**5.25%**	5.45%
Expected return on plan assets	**8.00%**	8.00%
Rate of increase in compensation	**3.50%**	3.50%

The Medical Center has a defined contribution plan. Pension expense for the defined contribution plan was $3,175,437and $2,944,299 for the years ended September 30, 2012 and 2011, respectively.

8. Long-Term Debt

Details of long-term debt are as follows:

	September 30	
	2012	**2011**
Intercompany debt with HHC:		
Series A, consisting of a tax exempt serial bond and term bonds; interest at rates ranging from 4.4% to 5.0%	**$ 82,094,766**	$ 82,094,766
Series C, taxable variable rate term bond	**5,032,987**	5,032,987
Premium on long-term debt	**1,603,562**	1,626,890
	$ 88,731,315	$ 88,754,643

On September 29, 2011, HHC issued approximately $375,815,000 of CHEFA Revenue Bonds Series A, B, and C (the HHC 2011 Bonds). In conjunction with the issuance of the 2011 Bonds, an obligated group was formed. The members of the obligated group are HHC, Hartford Hospital, The Hospital of Central Connecticut at New Britain General and Bradley Memorial, Windham Community Memorial Hospital and MidState Medical Center (collectively referred to as the "Obligated Group"). Obligated Group members are jointly and severally liable under a Master Trust Indenture (MTI) to make all payments required with respect to

8. Long-Term Debt (continued)

obligations under the MTI. HHC does have the right to name designated affiliates, although presently none exist. Though designated affiliates are not obligated to make debt service payments on the obligations under the MTI, each designated affiliate would have an independent designated affiliate agreement and promissory note with HHC with stipulated repayment terms and conditions, each subject to the governing law of the obligated groups' state of incorporation. In addition, HHC may cause each designated affiliate to transfer such amounts as necessary to enable the obligated group members to comply with the terms of the MTI, including payment of the outstanding obligations.

The HHC 2011 Bonds were issued to refund portions of existing debt under HHC, and to obtain funds for future capital needs. As such, the HHC 2011 Bonds are reflected as intercompany debt in the schedule above. The Medical Center is party to the HHC Series A and Series C Revenue Bonds.

The HHC Series A Revenue Bonds consist of serial bonds that mature annually from July 1, 2014 through July 1, 2023 and the term bonds mature from July 1, 2024 through July 1, 2041. The HHC Series C Revenue Bonds consist of term bonds that mature from July 1, 2042 through July 1, 2049. The HHC Series C Revenue Bonds are secured by an irrevocable letter of credit issued by JP Morgan Chase Bank which expires on October 1, 2016. The reimbursement terms of the letters of credit for the HHC Series C Revenue Bonds are such that in the event a letter of credit is drawn upon due to a failed remarketing the components available shall equal the aggregate principal and interest amount of bonds outstanding.

The MTI and Supplemental MTI provide for the potential establishment and maintenance of a Debt Service Reserve Fund, a pledge of gross receipts, as defined, and parity with the HHC Series A Revenue Bonds that remain outstanding. The MTI and loan agreements establish certain restrictive covenants, including debt service coverage ratio and days cash on hand requirement. No violations of covenants existed as of September 30, 2012 or 2011.

The fair value of the HHC 2011 Bonds was approximately $396,836,000 and $375,815,000 at September 30, 2012 and 2011, respectively. The carrying value of the HHC 2011 Bonds was $375,815,000 as of September 30, 2012 and 2011. The fair value of the HHC 2011 Bonds was determined by the Medical Center's investment advisor using a market approach that uses prices and other relevant information generated by market transactions involving identical or comparable liabilities.

8. Long-Term Debt (continued)

As part of the HHC 2011 Bonds, the Obligated Group entered into a line of credit for $20,000,000 from Bank of America which expires in March 2014. In 2012, the Obligated Group entered into a new $60,000,000 line of credit with another bank which expires in March 2013. As of September 30, 2012, and 2011, the Medical Center had not drawn on either line of credit.

The Medical Center entered in to an interest rate swap agreement (LIBOR Swap) in connection with a debt instrument that has subsequently been terminated, effective July 1, 2006, whereby the Medical Center receives a variable rate equal to 67% of one month LIBOR and pays a fixed rate of 3.777%. This agreement terminates July 1, 2026.

The fair value of the swap agreement was $6,478,759 and $5,720,844 at September 30, 2012 and 2011, respectively, and is recorded in other liabilities in the accompanying balance sheets. Although LIBOR Swap represents an economic hedge of the interest rate on the bonds, it does not qualify for hedge accounting. The change in the fair market value of this agreement is reported in the accompanying statements of operations and changes in net assets as a component of income from investments along with the net cash receipts on the swap agreement.

Scheduled principal repayments are as follows:

2014	$ 892,720
2015	1,010,352
2016	1,208,556
2017	1,302,017
Thereafter	82,714,108
	$ 87,127,753

Interest paid during 2012 and 2011 was $3,996,300 and $2,177,709, respectively.

9. Commitments and Contingencies

Various lawsuits and claims arising in the normal course of operations are pending or are in progress against the Medical Center. Such lawsuits and claims are either specifically covered by insurance as explained in Note 1 or are deemed to be immaterial. While the outcomes of the lawsuits cannot be determined at this time, management believes that any loss which may arise from these actions will not have a material adverse effect on the financial position or changes in net assets of the Medical Center.

9. Commitments and Contingencies (continued)

The Medical Center has non-cancelable operating leases, primarily for offsite properties. Rental expense for operating leases was $3,731,807 and $2,315,943 at September 30, 2012 and 2011, respectively.

Future minimum lease payments as of September 30, 2012 are:

2013	$ 2,215,567
2014	2,165,130
2015	2,078,186
2016	2,057,218
2017	1,968,985
Thereafter	13,087,132
Total minimum lease payments	$ 23,572,218

10. Related-Party Transactions

The Medical Center obtains services from various HHC affiliates that are recorded at cost that represent an allocation of shared expenditures. Services provided by affiliates for the year ended September 30, 2012 and 2011 were approximately $41,288,536 and $33,037,613, respectively. The Medical Center also provides services to certain of its affiliates and is reimbursed for the cost of these services. Fees charged to affiliates for the year ended September 30, 2012 and 2011, which are included in other operating revenue in the consolidated statement of operations and changes in net assets, were approximately $203,264 and $329,670, respectively. Included in due from affiliated entities within the consolidated balance sheets as of September 30, 2012 is $6,319,474 due from Hartford Hospital. Other intercompany activity with subsidiaries of MidState Medical Center include recurring transactions associated with operations and cash management which have been eliminated in consolidation.

11. Functional Expenses

The Medical Center provides health care services to residents within its geographic location. Net expenses related to providing these services are as follows:

	Year Ended September 30	
	2012	2011
Health care services	**$ 183,017,186**	$ 164,985,345
Support services	**54,667,471**	43,856,864
	$ 237,684,657	$ 208,842,209

12. Supplemental Cash Flow Information

The changes in assets and liabilities are as follows:

	Year Ended September 30	
	2012	2011
Increase in accounts receivable	**$ (7,932,285)**	$ (4,636,516)
Increase in other receivables	**(10,213,471)**	(6,240,380)
Increase in due from affiliated entities	**(6,319,474)**	–
Increase in inventories and prepaid expenses and other assets	**(916,421)**	(1,542,206)
Increase in other assets	**(8,815,457)**	(8,423,412)
Increase (decrease) in accounts payable	**1,518,097**	(2,790,292)
Increase in estimated third-party payor settlements	**1,761,887**	858,299
Increase in salaries, wages, payroll taxes and amounts withheld from employees	**977,272**	639,579
Decrease in accrued interest payable	–	(526,657)
Increase (decrease) in other accrued expenses	**5,883,402**	(7,405)
Increase in other liabilities	**17,527,534**	(3,235,836)
Decrease in accrued pension liability	**(2,296,231)**	(2,583,694)
	$ (8,825,147)	$ (28,488,520)

13. Subsequent Events

The Medical Center evaluated subsequent events through January 25, 2013, which is the date the financial statements were issued. No other events occurred that require disclosure or adjustment to the consolidated financial statements. Effective October 1, 2012, the Medical Center's ownership interest in CHS Insurance Limited was transferred to HHC as a result of HHC becoming the sole owner of CHS Insurance Ltd. In addition, the coverage levels for professional liability were amended. The primary level of coverage for all HHC entities will be $7,500,000 per claim and $30,000,000 in the aggregate. The primary level of excess coverage will be $20,000,000, shared by two insurance companies. Three other companies each cover additional layers of $10,000,000 for a total excess coverage of $60,000,000.

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Report of Independent Auditors on Supplementary Information

Board of Directors
MidState Medical Center and Subsidiaries

We have audited the consolidated financial statements of MidState Medical Center and Subsidiaries (the Medical Center) as of and for the years ended September 30, 2012 and 2011, and have issued our report thereon dated January 25, 2013, which contained an unqualified opinion on those consolidated financial statements. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating balance sheet and statement of operations are presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

January 25, 2013

MidState Medical Center and Subsidiaries

Consolidating Balance Sheet

September 30, 2012

	MidState Medical Center	Meriden Imaging Center, Inc.	MidState MSO, LLC	Total	Eliminating Entries	Consolidated
Assets						
Current assets:						
Cash and cash equivalents	$ 46,117,517	$ 1,755,332	$ 99,991	$ 47,972,840		$ 47,972,840
Accounts receivable, less allowances	25,147,640	–	–	25,147,640		25,147,640
Other receivables	8,170,030	862,730	3,407	9,036,167		9,036,167
Due from affiliated entities	6,319,474	–	–	6,319,474		6,319,474
Inventories of supplies	2,649,756	–	–	2,649,756		2,649,756
Prepaid expenses and other assets	2,739,748	49,465	–	2,789,213		2,789,213
Total current assets	91,144,165	2,667,527	103,398	93,915,090		93,915,090
Assets whose use is limited:						
Board-designated investments	13,032,246	–	–	13,032,246		13,032,246
Donor restricted investments	1,887,592	–	–	1,887,592		1,887,592
Funds designated for debt service	6,312,325	–	–	6,312,325		6,312,325
	21,232,163	–	–	21,232,163		21,232,163
Funds held in trust by others	13,223,292	–	–	13,223,292		13,223,292
Other assets	38,716,099	650	900,000	39,616,749	$ (2,584,257)	37,032,492
Property, plant and equipment, net	127,105,921	300,106	382,742	127,788,769		127,788,769
	$ 291,421,640	$ 2,968,283	$ 1,386,140	$ 295,776,063	$ (2,584,257)	$ 293,191,806
Liabilities and net assets						
Current liabilities:						
Accounts payable	$ 5,283,932	$ 211,942	$ -	$ 5,495,874		$ 5,495,874
Salaries, wages and amounts withheld from employee compensation	10,060,359	–	1,758	10,062,117		10,062,117
Estimated third-party payor settlements	3,562,417	–	–	3,562,417		3,562,417
Accrued expenses	6,034,847	317,370	42,972	6,395,189		6,395,189
Current portion of accrued pension liabilit	2,429,187	–	–	2,429,187		2,429,187
Current portion of other liabilities	2,236,550	–	–	2,236,550		2,236,550
Total current liabilities	29,607,292	529,312	44,730	30,181,334		30,181,334
Accrued pension liability	56,785,518	–	–	56,785,518		56,785,518
Other liabilities	26,378,887	–	–	26,378,887	$ 487,794	26,866,681
Long-term debt	88,731,315	–	–	88,731,315		88,731,315
Net assets:						
Unrestricted	73,637,750	2,438,971	1,341,410	77,418,131	(3,072,051)	74,346,080
Temporarily restricted	2,279,087	–	–	2,279,087	–	2,279,087
Permanently restricted	14,001,791	–	–	14,001,791	–	14,001,791
	89,918,628	2,438,971	1,341,410	93,699,009	(3,072,051)	90,626,958
	$ 291,421,640	$ 2,968,283	$ 1,386,140	$ 295,776,063	$ (2,584,257)	$ 293,191,806

MidState Medical Center and Subsidiaries

Consolidating Statement of Operations

Year Ended September 30, 2012

	MidState Medical Center	Meriden Imaging Center, Inc.	MidState MSO, LLC	Total	Eliminating Entries	Consolidated
Gross revenue from patients	$ 479,645,635			$ 479,645,635		$ 479,645,635
Deductions:						
Allowances	257,058,291			257,058,291		257,058,291
Charity care	4,233,596			4,233,596		4,233,596
Provision for bad debts	6,461,499			6,461,499		6,461,499
Net patient service revenue	211,892,249			211,892,249		211,892,249
Other operating revenue	27,519,593	$ 8,881,457	$ 5,494,418	41,895,468	$ (8,352)	41,887,116
Net assets released from restrictions	327,257	–	–	327,257		327,257
	239,739,099	8,881,457	5,494,418	254,114,974	(8,352)	254,106,622
Operating expenses:						
Salaries	75,938,860	–	2,157,078	78,095,938		78,095,938
Employee benefits	28,088,853	–	660,741	28,749,594		28,749,594
Supplies and other	43,473,306	2,111,399	1,694,239	47,278,944		47,278,944
Purchased services	50,385,547	6,576,402	888,896	57,850,845		57,850,845
Provision for non-patient bad debts	–	–	8,498,226	8,498,226		8,498,226
Depreciation and amortization	12,961,930	151,894	100,986	13,214,810		13,214,810
Interest	3,996,300	–		3,996,300		3,996,300
	214,844,796	8,839,695	14,000,166	237,684,657		237,684,657
Income (loss) from operations	24,894,303	41,762	(8,505,748)	16,430,317	(8,352)	16,421,965
Non-operating income (loss):						
Income from investments, gifts and bequests, net	1,448,167	–	–	1,448,167		1,448,167
Loss on interest rate swap	(1,587,712)	–	–	(1,587,712)		(1,587,712)
	(139,545)	–	–	(139,545)		(139,545)
Excess (deficiency) of revenues over expenses before change in unrealized gains and losses on investments	24,754,758	41,762	(8,505,748)	16,290,772	(8,352)	16,282,420
Change in unrealized gains and losses on investments	1,362,036	–	–	1,362,036		1,362,036
Excess (deficiency) of revenues over expenses	$ 26,116,794	$ 41,762	$(8,505,748)	$ 17,652,808	$ (8,352)	$ 17,644,456