Consolidated Financial Statements and Supplementary Information

Yale-New Haven Hospital, Inc. and Subsidiaries
Years Ended September 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

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Consolidated Financial Statements
and Supplementary Information

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Contents

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Report of Independent Auditors

Board of Trustees
Yale-New Haven Hospital, Inc.

We have audited the accompanying consolidated balance sheets of Yale-New Haven Hospital, Inc. and Subsidiaries (the "Hospital") 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 Hospital'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 and the standard 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 of material misstatement. We were not engaged to perform an audit of the Hospital'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 Hospital'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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Yale-New Haven Hospital, Inc. and Subsidiaries at September 30, 2012 and 2011, and the consolidated results of its operations and changes in its net assets and its cash flows for the years then ended in conformity with generally accepted accounting principles in the U.S.

As discussed in Notes 1 and 9 to the accompanying consolidated financial statements, in 2012 the Hospital changed its method of accounting for estimated insurance claims receivable and insurance claims liabilities with the adoption of Accounting Standards Update 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries.*

Ernst & Young LLP

December 21, 2012

Yale-New Haven Hospital, Inc. and Subsidiaries

Consolidated Balance Sheets

	September 30 2012	September 30 2011
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 64,557**	$ 65,883
Short-term investments	**613,360**	402,559
Accounts receivable for services to patients, less allowance for uncollectible accounts, charity and free care of approximately $59,610,000 in 2012 and $43,206,000 in 2011	**202,909**	167,383
Other receivables	**48,641**	56,201
Professional liabilities insurance recoveries receivable – current portion	**15,739**	13,514
Other current assets	**47,394**	24,630
Amounts on deposit with trustee in debt service fund	**6,619**	6,320
Total current assets	**999,219**	736,490
Assets limited as to use	**105,688**	129,997
Long-term investments	**164,238**	141,525
Deferred financing costs, less accumulated amortization	**5,182**	5,488
Professional liabilities insurance recoveries receivable – non-current	**40,271**	50,081
Goodwill	**35,685**	–
Other assets	**177,199**	129,845
Property, plant, and equipment:		
Land and land improvements	**33,191**	19,467
Buildings and fixtures	**1,068,530**	952,346
Equipment	**426,413**	419,565
	1,528,134	1,391,378
Less accumulated depreciation	**601,670**	566,850
	926,464	824,528
Construction in progress	**63,603**	43,207
	990,067	867,735
Total assets	**$ 2,517,549**	$ 2,061,161

	September 30	
	2012	**2011**
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 134,051**	$ 99,381
Accrued expenses	**168,508**	120,959
Professional liabilities- current portion	**15,739**	13,514
Current portion of long-term debt	**45,198**	10,185
Current portion of capital lease obligation	**55,292**	2,862
Other current liabilities	**2,926**	3,848
Total current liabilities	**421,714**	250,749
Long-term debt, net of current portion	**674,969**	509,022
Capital lease obligation, net of current portion	**52,237**	107,529
Accrued pension and postretirement benefit obligations	**280,718**	240,901
Professional liabilities	**105,313**	75,533
Other long-term liabilities	**180,195**	155,019
Deferred revenue	**53,625**	48,321
Total liabilities	**1,768,771**	1,387,074
Commitments and contingencies		
Net assets:		
Unrestricted	**676,008**	604,617
Temporarily restricted	**46,026**	43,947
Permanently restricted	**26,744**	25,523
Total net assets	**748,778**	674,087
Total liabilities and net assets	**$ 2,517,549**	$ 2,061,161

See accompanying notes.

Yale-New Haven Hospital, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended September 30	
	2012	**2011**
	(In Thousands)	
Operating revenue:		
Net patient service revenue	**$ 1,713,271**	$ 1,442,057
Other revenue	**47,684**	46,640
Total operating revenue	**1,760,955**	1,488,697
Operating expenses:		
Salaries and benefits	**757,263**	690,314
Supplies and other expenses	**758,058**	620,912
Depreciation	**73,101**	67,948
Insurance	**15,680**	13,376
Bad debts	**32,622**	26,390
Interest	**17,720**	16,867
Total operating expenses	**1,654,444**	1,435,807
Income from operations	**106,511**	52,890
Non-operating gains and losses, net	**24,098**	14,272
Excess of revenue over expenses	**130,609**	67,162

(Continued on next page.)

Yale-New Haven Hospital, Inc. and Subsidiaries

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

	Year Ended September 30	
	2012	**2011**
	(In Thousands)	
Unrestricted net assets:		
Other changes in net assets	**$ 342**	$ (273)
Transfer to Yale-New Haven Health Services Corporation – Clinical Development Fund	**(9,000)**	(12,000)
Transfer from Yale-New Haven Health Services Corporation	**2,900**	2,900
Net transfer from Yale-New Haven Network Corporation	**456**	6,250
Net assets released from restrictions for purchases of fixed assets	**258**	1,774
Pension and other postretirement liability adjustments	**(54,174)**	(28,727)
Increase in unrestricted net assets	**71,391**	37,086
Temporarily restricted net assets:		
Income from investments	**280**	512
Net realized gains on investments	**471**	3,065
Change in net unrealized gains and losses on investments	**6,394**	319
Bequests, contributions, and grants	**11,847**	15,280
Net assets released from restrictions for purchases of fixed assets	**(258)**	(1,774)
Net assets released from restrictions for free care	**(889)**	(782)
Net assets released from restrictions for operations	**(2,962)**	(5,003)
Net assets released from restrictions for clinical programs	**(12,804)**	(16,195)
Increase (decrease) in temporarily restricted net assets	**2,079**	(4,578)
Permanently restricted net assets:		
Change in beneficial interest in perpetual trusts	**1,221**	(733)
Increase (decrease) in permanently restricted net assets	**1,221**	(733)
Increase in net assets	**74,691**	31,775
Net assets at beginning of year	**674,087**	642,312
Net assets at end of year	**$ 748,778**	$ 674,087

See accompanying notes.

Yale-New Haven Hospital, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended September 30	
	2012	**2011**
	(In Thousands)	
Cash flows from operating activities		
Increase in net assets	**$ 74,691**	$ 31,775
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation	**73,101**	67,948
Net realized and change in net unrealized gains and losses on investments	**(60,465)**	(21,801)
Change in fair value of interest rate swap agreements	**7,318**	4,421
Amortization of long-term debt premium	**(854)**	(885)
Amortization of deferred financing costs	**306**	317
Bad debts	**32,622**	26,390
Change in perpetual trusts	**(1,221)**	733
Transfer to Yale-New Haven Health Services Corporation – Clinical Development Fund	**9,000**	12,000
Transfer from Yale-New Haven Health Services Corporation	**(2,900)**	(2,900)
Transfer from YNH- Network Corporation	**(456)**	(6,250)
Bequests, contributions and grants, net of restricted pledges	**(14,807)**	(16,941)
Pension and other postretirement liability adjustments	**54,174**	28,727
Changes in operating assets and liabilities:		
Accounts receivable, net	**(68,148)**	(58,328)
Other receivables	**14,960**	(20,152)
Other assets	**7,593**	(56,621)
Accounts payable	**34,670**	(1,597)
Accrued expenses	**1,130**	12,574
Professional insurance recoveries and liabilities	**39,590**	2,103
Other current liabilities, accrued pension and postretirement benefit obligations, other long-term liabilities, and deferred revenue	**(32,851)**	27,019
Net cash provided by operating activities	**167,453**	28,532
Cash flows from investing activities		
Net acquisitions of property, plant, and equipment	**(97,254)**	(79,667)
Capitalized interest	**1,977**	3,054
Cash paid for acquisition, net of cash acquired	**(133,800)**	–
Net change in investments	**(173,049)**	(27,189)
Increase in debt service fund	**(299)**	(1,696)
Assets whose use is limited	**25,530**	(65,079)
Transfer to Yale-New Haven Health Services Corporation – Clinical Development Fund	**(9,000)**	(12,000)
Transfer from YNH Network Corporation	**456**	6,250
Transfer from Yale-New Haven Health Services Corporation	**2,900**	2,900
Net cash used in investing activities	**(382,539)**	(173,427)
Cash flows from financing activities		
Proceeds from issuance of debt	**–**	105,436
Proceeds from note payable	**212,000**	40,000
Payments on capital lease obligation	**(2,862)**	(2,622)
Repayments of long-term debt	**(10,185)**	(13,577)
Deferred financing costs	**–**	(1,956)
Bequests, contributions and grants, net of pledges	**14,807**	16,941
Net cash provided by financing activities	**213,760**	144,222
Net decrease in cash and cash equivalents	**(1,326)**	(673)
Cash and cash equivalents at beginning of year	**65,883**	66,556
Cash and cash equivalents at end of year	**$ 64,557**	$ 65,883

See accompanying notes.

1. Organization and Significant Accounting Policies

Organization

Yale-New Haven Hospital, Inc. (the "Hospital") is a voluntary association incorporated under the General Statutes of the State of Connecticut. YNH Network Corporation ("YNHNC"), a Connecticut not-for-profit corporation, is the sole member of the Hospital, and serves as the sole member/parent for a delivery network of regional healthcare providers and related entities.

Yale-New Haven Health Services Corporation ("YNHHSC") is the sole member of YNHNC and two similar organizations. Each of these three tax-exempt organizations serves as the sole member/parent for its respective delivery network of regional healthcare providers and related entities. The Hospital continues to operate with a separate Board of Trustees, management staff and medical staff; however, YNHNC approves the Hospital's strategic plans, operating and capital budgets, and Board of Trustees appointments.

Acquisition

On September 12, 2012, the Hospital, Yale-New Haven Ambulatory Services Corporation ("ASC"), a wholly-owned subsidiary of YNHNC, Yale-New Haven Care Continuum Corporation ("YNHCCC"), a wholly owned subsidiary of YNHNC, and Medical Center Pharmacy and Home Care Center, Inc., a subsidiary of York Enterprise, Inc. ("York") which is a wholly owned subsidiary of YNHNC, acquired substantially all of the business, assets, and operations and assumed certain liabilities of the Saint Raphael Healthcare System, Inc. ("SRHS"), including substantially all of the assets of its wholly-owned subsidiary, the Hospital of Saint Raphael ("HSR"), a 511-bed acute care hospital located in New Haven, CT. Other affiliates of SRHS whose assets were acquired in connection with the transaction include the following:

- Saint Regis Health Center, Inc. d/b/a Sister Anne Virginie Grimes Health Center ("Grimes"), a tax-exempt, skilled nursing facility that operated with 120 licensed beds which was a wholly-owned subsidiary of SRHS. In connection with the transaction, YNHCCC acquired substantially all of the land, buildings, equipment and bed licenses associated with Grimes.

- Caritas Insurance Company, Ltd. ("Caritas") a Vermont-domiciled, captive insurance company licensed under Chapter 141 of Title 8 of the Vermont Statutes Annotated. Caritas is a tax-exempt supporting organization having the Hospital as its sole shareholder. Caritas provides excess professional liability coverage and general liability coverage. Caritas was a wholly-owned subsidiary of HSR.

1. Organization and Significant Accounting Policies (continued)

- Lukan Indemnity Company, Ltd. ("Lukan") a Bermuda-domiciled captive insurance company that provides primary professional liability coverage. Lukan was a wholly-owned subsidiary of HSR. In connection with the transaction, the Hospital acquired 100% of the stock of Lukan.

- DePaul Health Services Corporation ("DePaul") a Connecticut nonstock corporation which held interests in joint ventures and other assets on behalf of HSR. In connection with the transaction, ASC acquired certain interests in investments from DePaul.

- Saint Raphael Foundation, Inc. (the "Foundation") a tax-exempt fundraising foundation of HSR which was a subsidiary of SRHS. In connection with the transaction, certain assets of the Foundation were acquired by the Hospital.

The total consideration transferred by the Hospital, ASC, YNHCCC and York was approximately $237.9 million, including $160.0 million in cash and an installment payable plus the assumption of liabilities totaling $77.9 million, as follows (in thousands).

Cash consideration	$ 150,000
Installment payments	10,000
Assumption of liabilities	77,927
Total consideration transferred	$ 237,927

The acquisition of substantially all of the business, assets, and operations and assumption of liabilities of HSR included installment payments in the amount of $10 million payable in two equal installments in October 2012 and March 2013. The first installment payment of $5 million was made on October 12, 2012.

The Hospital and its affiliates have accounted for the business combination applying the acquisition method of accounting in accordance with Accounting Standards Codification Topic 805, *Business Combinations*.

1. Organization and Significant Accounting Policies (continued)

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the acquisition date. Determining the fair value of the assets acquired and liabilities assumed requires judgment and involves the use of significant accounting estimates and assumptions, including assumptions with respect to future cash inflows and outflows and discount rates, among others.

	Hospital	ASC	YNHCCC	York	Total
Assets acquired:					
Cash	$ 16,200	$ –	$ –	$ –	$ 16,200
Other current assets	7,240	–	–	187	7,427
Other receivables	7,400	–	–	–	7,400
Goodwill	35,685	–	–	–	35,685
Other long-term assets	53,771	12,500	700	–	66,971
Property, plant and equipment	100,156	–	4,075	13	104,244
	220,452	12,500	4,775	200	237,927
Liabilities assumed:					
Accrued expenses	36,419	–	775	–	37,194
Other long-term liabilities	40,733	–	–	–	40,733
Total	77,152	–	775	–	77,927
Assets and liabilities acquired	$ 143,300	$ 12,500	$ 4,000	$ 200	$ 160,000
Cash paid for acquisition	$ 150,000	$ –	$ –	$ –	$ 150,000
Installment payments	$ 10,000	$ –	$ –	$ –	10,000
Change in net assets					$ –

The Hospital recorded goodwill in the amount of $35.7 million. In determining the amount of goodwill, all assets acquired and liabilities assumed were measured at fair value as of the acquisition date. Factors contributing to goodwill that resulted from the acquisition include, but are not limited to, the efficiencies that will result from the combination of the campuses and their proximity.

YNHCCC, ASC and York each respectively paid amounts equal to the fair values for assets acquired, net of liabilities assumed, with cash provided by the Hospital.

The results of the business, assets, and operations acquired for the period September 12, 2012 through September 30, 2012 have been combined with the Hospital and included in the consolidated financial statements.

1. Organization and Significant Accounting Policies (continued)

The following table summarizes amounts attributed to HRS since the acquisition date that are included in the accompanying consolidated financial statements (in thousands):

	Period From September 12, 2012 to September 30, 2012
Total operating revenue	$ 22,260
Total operating expense	23,532
Loss from operations	(1,272)
Non-operating gains and losses, net	71
Deficiency of revenue over expenses	$ (1,201)
Change in net assets:	
Unrestricted net assets	$ (1,201)
Temporarily restricted net assets	–
Permanently restricted net assets	–
Total change in net assets	$ (1,201)

The following table represents pro forma financial information, assuming the acquisition of HRS had taken place October 1, 2010. The pro forma information includes adjustments for the amortization of intangible assets. The pro forma financial information is not necessarily indicative of the results of operations as they would have been had the transaction been effected on the acquisition date (in thousands).

	Year Ended September 30	
	2012	**2011**
Total operating revenue	**$ 2,257,918**	$ 1,993,214
Total operating expense	**2,162,129**	1,937,853
Gain from operations	**95,789**	55,361
Non-operating gains and losses, net	**25,465**	14,665
Excess of revenue over expenses	**$ 121,254**	$ 70,026
Change in net assets:		
Unrestricted net assets	**$ 74,634**	$ (1,616)
Temporarily restricted net assets	**(2,389)**	(2,507)
Permanently restricted net assets	**921**	(2,712)
Total change in net assets	**$ 73,166**	$ (6,835)

1. Organization and Significant Accounting Policies (continued)

Principles of Consolidation

The accompanying consolidated financial statements present the accounts and transactions of the Hospital and its wholly-owned subsidiaries Caritas and Lukan. All significant intercompany revenue and expenses and intercompany balance sheet accounts have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, including estimated uncollectibles for accounts receivable for services to patients, and liabilities, including estimated net settlements with third-party payors and professional liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the amounts of revenue and expenses reported during the 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 those estimates.

During fiscal 2012 and 2011, the Hospital recorded a change in estimate of approximately $10.2 million and $10.6 million, respectively. Included in the change are amounts related to favorable third-party payor settlements at September 30, 2012 and 2011, respectively.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose and appreciation on permanently restricted net assets. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity. The Hospital 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 unrestricted and the assets are classified as permanently restricted.

The restricted funds investments are pooled with unrestricted investments to facilitate their management. Investment income is allocated to the restricted funds using the market value unit method. The Board of Trustees approves spending for certain pooled funds based on total return. Realized gains and losses from the sale of securities are computed using the average cost method.

1. Organization and Significant Accounting Policies (continued)

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.

Contributions receivable to be received after one year are discounted at a discount rate commensurate with the risks involved. Amortization of the discount is recognized as revenue and is classified as either unrestricted or temporarily restricted in accordance with donor imposed restrictions, if any, on the contributions.

Contributions receivable, included in other receivables and other assets in the accompanying consolidated balance sheets at September 30, 2012 and 2011, are expected to be received as follows (in thousands):

	September 30	
	2012	**2011**
Less than one year	**$ 1,596**	$ 1,187
One to five years	**2,054**	1,662
	3,650	2,849
Less unamortized discount on contributions receivable (0.2% to 4.2%)	**(108)**	(174)
	3,542	2,675
Allowance for uncollectible contributions	**(106)**	(80)
	$ 3,436	$ 2,595

Donor Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. All 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.

1. Organization and Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid financial instruments with original maturities of three months or less when purchased, which are not classified as assets limited as to use and which are not maintained in the short-term or long-term investment portfolios.

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

Accounts Receivable

Patient accounts receivable result from the health care services provided by the Hospital. 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 payor programs.

Investments

The Hospital has designated its investment portfolio as trading. Investment income or loss (including realized gains and losses on investments, interest and dividends) and the change in net unrealized gains and losses are included in the excess of revenue over expenses unless the income or loss is restricted by donor or law.

Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value (quoted market prices) in the accompanying consolidating balance sheets.

1. Organization and Significant Accounting Policies (continued)

The Hospital participates in the Yale New Haven Health System Investment Trust (the "Trust"), a unitized Delaware Investment Trust created to pool assets for investment by the Health System non-profit entities. The Trust is comprised of two pools: the Long-Term Investment Pool ("L-TIP") and the Intermediate-Term Investment Pool ("I-TIP"). Governance of the Trust is performed by the Yale New Haven Health System Investment Committee.

Under the terms of the investment management agreement with the Trust, withdrawals of the Hospital's investment in the L-TIP can be made annually by the Hospital on July 1. Amounts withdrawn are subject to a schedule that allows larger withdrawals with longer notice periods. As of September 30, 2012, the Hospital can withdraw 100% of its investment in the L-TIP on July 1, 2013. Withdrawals of the Hospital's investment in the I-TIP in any amount can be made quarterly with 30 days advance notice.

Certain alternative investments (non-traditional, not-readily-marketable assets) are structured such that the Hospital holds limited partnership interests or pooled units and are accounted for under the equity method and utilizing Yale University's (the "University") reported net asset value per unit for measurement of the units' fair value for the Yale University investment.

Individual investment holdings within the alternative investments may, in turn, include investments in both non-marketable and market-traded securities. Valuations of those investments and, therefore, the Hospital's holdings may be determined by the investment manager or general partner. Fund of funds investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. The equity method reflects net contributions to the investee and an ownership share of realized and unrealized investment income and expenses. The investments may indirectly expose the Hospital to securities lending, short sales of securities, and trading in futures and forwards contracts, options, swap contracts and other derivative products. While these financial instruments may contain varying degrees of risk, the Hospital's risk with respect to such transactions is limited to its capital balance in each investment. The financial statements of the investees are audited annually by independent auditors. The Hospital has made investment commitments of approximately $80.9 million in these alternative investments, of which approximately $77.4 million has been funded as of September 30, 2012.

1. Organization and Significant Accounting Policies (continued)

The Trust has an agreement with the University's investment office (the "Investment Management Agreement") which allows the University to manage a portion of the Trust's investments as part of the University's Endowment Pool (the "Pool"). Under the terms of the agreement for the years ended September 30, 2012 and 2011, the Trust transferred $50.0 million and $100.0 million, respectively, to the University in exchange for units in the Pool. The Trust's interest in the Pool is reported at fair value based on the net asset value per units held. The Pool invests in domestic equity, foreign equity, absolute return, private equity, real estate, fixed income and cash.

Under the terms of the investment management agreement with the University, withdrawals of the Trust's investment in the Pool can be made annually by the Trust on July 1. For withdrawals of amounts less than $150.0 million or 75% of the Trust's investment in the Pool, $100.0 million or 50% of the Trust's investment in the Pool, and $50.0 million or 25% of the Trust's investment in the Pool, the advance notice period is set to a maximum of 180 days, 90 days, and 30 days, respectively, prior to the University's fiscal year ending June 30. For withdrawals greater than $150.0 million or more than 75% of the Trust's investment in the Pool, the advance notice period is set to a maximum of 270 days prior to the University's fiscal year end of June 30.

In March 2006, the Hospital entered into an arrangement with the University whereby the University will manage certain Board-designated assets of the Hospital. These Board-designated assets are commingled in the University's endowment pool. At September 30, 2012 and 2011, the carrying value of assets managed by the University under this arrangement was approximately $8.5 million and $8.6 million, respectively. Because of the limitations on their use, the assets are separately classified from assets invested under the Investment Management Agreement.

In 2011, the investment management agreement between the Trust and the University was modified to allow the Trust to obtain a cash advance, up to a maximum of $75 million, on a monthly basis. For these advances interest of U.S. Prime rate, plus two percent (2%) will be paid by the Trust. Repayments on the advances are made by the Trust by way of redemptions of a sufficient number of Trust's units in the Endowment using the June 30th unit valuation. No advances have been requested or taken by the Trust.

Short-term investments represent those securities that are available for the Hospital's operations and can be converted to cash within one year.

1. Organization and Significant Accounting Policies (continued)

Inventories

Inventories are stated at the lower of cost or market. The Hospital values its inventories using the first-in, first-out method with the exception of pharmacy inventories, which are valued at average cost.

Assets Limited as to Use

Assets so classified represent assets held by trustees under indenture agreements, beneficial interest in perpetual trusts and designated assets set aside by the Board of Trustees for future capital improvements and other Board approved uses. The Board of Trustees retains control and, at its discretion, may use for other purposes assets limited as to use for plant improvements and expansion. Amounts required to meet current liabilities are reported as current assets. These funds primarily consist of U.S. government securities, mutual funds, and money market funds.

Perpetual Trusts

The Hospital is the beneficiary of certain perpetual trusts held and administered by others. The present values of the estimated future cash receipts, which are measured based on the fair value of the assets held by the trust, are recognized as assets and contribution revenues at the dates the trusts are established. Distributions from the trusts related to earnings and investment income are recorded as contributions and the carrying value of the assets is adjusted for changes in the fair value.

Interest Rate Swap Agreements

The Hospital utilizes interest rate swap agreements to reduce risks associated with changes in interest rates. Interest rate swap agreements are reported at fair value. The Hospital is exposed to credit loss in the event of non-performance by the counterparties to its interest rate swap agreements. The Hospital is also exposed to the risk that the swap receipts may not offset its variable rate debt service. To the extent these variable rate payments do not equal variable interest payments on the bonds, there will be a net loss or net benefit to the Hospital.

1. Organization and Significant Accounting Policies (continued)

Benefits and Insurance

The Hospital is effectively self-insured for medical, hospitalization, and prescription drug benefits provided to employees. The Hospital makes annual contributions to the YNHHSC Voluntary Employee Beneficiary Association ("VEBA") plan to fund medical, dental, hospitalization, group term life insurance and prescription drug benefits. Annually, premiums are set to reflect the estimated cost of benefits. During the years ended September 30, 2012 and 2011, the Hospital made actuarially determined contributions, net of premium adjustments, to the VEBA plan of approximately $102.4 million and $89.3 million, respectively.

The Hospital is self-insured for workers' compensation claims. Estimated amounts are accrued for claims, including claims incurred but not reported ("IBNR") and are based on Hospital-specific experience. At September 30, 2012 and 2011, the estimated discounted liabilities for self-insured workers' compensation claims and IBNR aggregated approximately $13.3 million, discounted at 3.0%, and $13.4 million, discounted at 3.5%, respectively, and are included in accrued expenses in the accompanying consolidated balance sheets.

Professional Liability Insurance

The Hospital participates in the YNHHSC coordinated professional liability program. Based on the terms of the agreement with YNHHSC, the Hospital records the actuarially determined liabilities for IBNR professional and general liabilities and has recorded a deposit (asset) for liabilities transferred in the year ended September 30, 1998.

Property, Plant, and Equipment

Property, plant, and equipment purchased are carried at cost and those acquired by gifts and bequests are carried at fair value established at date of contribution. The carrying amounts of assets and the related accumulated depreciation are removed from the accounts when such assets are disposed of and any resulting gain or loss is included in income from operations. Depreciation of property, plant, and equipment is computed by the straight-line method in amounts sufficient to depreciate the cost of the assets over their estimated useful lives ranging from 3 to 50 years. The cost of additions and improvements are capitalized and expenditures for repairs and maintenance, including the cost of replacing minor items not considered substantial enhancements, are expensed as incurred.

1. Organization and Significant Accounting Policies (continued)

The Hospital and the Housing Authority of New Haven ("HANH") have entered into an agreement to swap parcels of land on the Legion/Howard/Sylvan/Ward block located in New Haven, Connecticut. As part of the key terms of the agreement, HANH has pledged an account to the Hospital in the amount of $5.7 million. The pledged account was established at the time the Hospital conveyed the land to HANH in July 2010. In the event that HANH fails to meet certain requirements of the agreement, including conveying its land parcel to the Hospital, the Hospital has the right to withdraw from the pledged account in the amount of $5.2 million, unless the pledged account is extended with an annual increase of approximately $180,000. As of September 30, 2012, no events have occurred that would require an increase to the pledged account or that would require the Hospital to withdraw funds from the pledged account.

Goodwill

Goodwill is not amortized but instead tested at least annually for impairment or more frequently when events or changes in circumstances indicate that the assets might be impaired. This impairment test is performed annually at the reporting unit level. The Hospital evaluates goodwill at the entity level as management has determined that the Hospital's operation comprise a single reporting entity. Goodwill is considered to impaired if the carrying value of the reporting unit, including goodwill, exceeds the reporting unit's fair value. Reporting unit fair value is estimated using both income (discounted cash flows) and market approaches.

The discounted cash flow approach requires the use of assumptions and judgments including estimates of future cash flows and the selection of discount rates. The market approach relies on comparisons to publicly traded stocks or to sales of similar companies. The Hospital has determined that no goodwill impairment exists at September 30, 2012.

Deferred Revenue

Deferred revenue includes amounts which have been received that relate to future years. Amounts will be reduced as revenue is earned.

Excess of Revenue Over Expenses

In the accompanying statements of operations and changes in net assets, excess of revenue over expenses is the performance indicator. Peripheral or incidental transactions are included in excess of revenue over expenses. Those gains and losses deemed by management to be closely

1. Organization and Significant Accounting Policies (continued)

related to ongoing operations are included in other revenue; other gains and losses are classified as non-operating gains and losses. Included in non-operating gains and losses are expenses incurred related to the acquisition of the Saint Raphael.

Consistent with industry practice, contributions of, or restricted to, property, plant, and equipment, transfers of assets to and from affiliates for other than goods and services, and pension and other post-retirement liability adjustments are excluded from the performance indicator but are included in the changes in net assets.

Income Taxes

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the "Code"), and is exempt from Federal income taxes on related income pursuant to Section 501(a) of the Code. The Hospital also is exempt from state income tax.

Operating Expenses

The Hospital records amounts received from the University, area hospitals and other local healthcare providers for costs incurred on behalf of those organizations as reductions to expenses. For the years ended September 30, 2012 and 2011, the Hospital recorded approximately $52.9 million as reductions to expenses.

Deferred Financing Costs

The Hospital capitalizes costs incurred in connection with the issuance of long-term debt and amortizes these costs over the life of the respective obligations using the effective interest method.

Impairment of Assets

The Hospital reviews property, equipment and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If such impairment indicators are present, the Hospital recognizes a loss on the basis of whether these amounts are fully recoverable.

1. Organization and Significant Accounting Policies (continued)

Change in Accounting Principle

In August 2010, the Financial Accounting Standards Board ("FASB") issued ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*, which provides clarification to companies in the health care industry on the accounting for and presentation of professional and similar contingent liabilities. Under the new guidance, these liabilities should not be presented net of insurance recoveries and an insurance recovery receivable should be recognized on the same basis as the liabilities, subject to the need for a valuation allowance for uncollectible accounts. The new guidance became effective for the Hospital as of October 1, 2011. The Hospital elected to retrospectively adopt the guidance as of October 1, 2010. The adoption resulted in an increase to current assets and liabilities of approximately $13.5 million and an increase to long-term assets and liabilities of approximately $50.1 million as of September 30, 2011. The adoption did not affect the Hospital's financial condition, net results of operations, or cash flows.

New Accounting Pronouncements

In July 2011, the FASB issued Accounting Standards Update No. 2011-07, "Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities" ("ASU 2011-07"). Under ASU 2011-07, provision for bad debts related to patient service revenue will be presented as a deduction from patient service revenue (net of contractual allowances and discounts) on the statement of operations with enhanced footnote disclosure on the policies for recognizing revenue and assessing bad debts. The Hospital will adopt the presentation changes to the statement of operations for periods beginning after December 15, 2011.

In August 2010, the FASB issued Accounting Standards Update ("ASU") 2010-23, *Measuring Charity Care for Disclosure*. The new guidance requires that the level of charity care provided be presented based on the direct and indirect costs of the charity services provided. Separate disclosure of the amount of any cash reimbursements received for providing charity care must also be disclosed. The new disclosure requirements became effective for the Hospital on October 1, 2011 and are included in the accompanying consolidated financial statements for all periods presented.

1. Organization and Significant Accounting Policies (continued)

Reclassifications

Certain reclassifications have been made to the year ended September 30, 2011 balances previously reported in the balance sheets in order to conform with the year ended September 30, 2012 presentation.

2. Accounts Receivable for Services to Patients and Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. The difference is accounted for as allowances. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, fee-for-service, discounted charges and per diem payments. Net patient service revenue is affected by the State of Connecticut Disproportionate Share program, includes premium revenue and is reported at the estimated net realizable amounts due from patients, third-party payors and others for services rendered and includes estimated retroactive revenue adjustments due to 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.

Third-party payor receivables included in other receivables were $28.4 million and $31.1 million at September 30, 2012 and 2011, respectively. Third-party payor receivables included in other long-term assets were $16.7 million and $12.3 million at September 30, 2012 and 2011, respectively. Third-party payor liabilities included in other current liabilities were $2.8 million and $1.3 million at September 30, 2012 and 2011, respectively. Third-party payor liabilities included in other long-term liabilities were $28.6 million and $28.3 million at September 30, 2012 and 2011, respectively.

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

Additionally, certain payors' 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.

2. Accounts Receivable for Services to Patients and Net Patient Service Revenue (continued)

Revenue from Medicare and Medicaid programs accounted for approximately 27% and 14%, respectively, of the Hospital's net patient service revenue for the year ended September 30, 2012 and approximately 29% and 14%, respectively, of the Hospital's net patient service revenue for the year ended September 30, 2011. Inpatient discharges relating to Medicare and Medicaid programs accounted for approximately 30% and 29%, respectively, for the year ended September 30, 2012 and approximately 31% and 28%, respectively, for the year ended September 30, 2011. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and are 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 Hospital 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 except as disclosed in Note 10. 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. Cost reports for the Hospital, which serve as the basis for final settlement with government payors, have been settled by final settlement through 2006 for Medicare and 1995 for Medicaid. Other years remain open for settlement.

The significant concentrations of accounts receivable for services to patients include 28% from Medicare, 11% from Medicaid, and 61% from non-governmental payors at September 30, 2012 and 30% from Medicare, 8% from Medicaid, and 62% from non-governmental payors at September 30, 2011.

Net patient service revenue is comprised of the following for the years ended September 30, 2012 and 2011 (in thousands):

	2012	2011
Gross revenue from patients	**$ 5,740,304**	$ 4,443,296
Deductions:		
Contractual allowances	**3,948,050**	2,939,940
Charity and free care (at charges)	**78,983**	61,299
Net patient service revenue	**$ 1,713,271**	$ 1,442,057

3. Uncompensated Care and Community Benefit Expense

The Hospital's commitment to community service is evidenced by services provided to the poor and benefits provided to the broader community. Services provided to the poor include services provided to persons who cannot afford healthcare because of inadequate resources and/or who are uninsured or underinsured.

The Hospital makes available free care programs for qualifying patients. In accordance with the established policies of the Hospital, during the registration, billing and collection process a patient's eligibility for free care funds is determined. For patients who were determined by the Hospital to have the ability to pay but did not, the uncollected amounts are classified as bad debt expense. For patients who do not avail themselves of any free care program and whose ability to pay cannot be determined by the Hospital, care given but not paid for, is classified as charity care.

Together, charity care and bad debt expense represent uncompensated care. The estimated cost of total uncompensated care is approximately $69.8 million and $55.9 million for the years ended September 30, 2012 and 2011, respectively. The estimated cost of uncompensated care is based on the ratio of cost to charges, as determined by claims activity.

The estimated cost of charity care provided was $47.8 million and $32.3 million 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. The allocation between bad debt and charity care is determined based on management's analysis on the previous 12 months of hospital data. This analysis calculates the actual percentage of accounts written off or designated as bad debt versus charity care while taking into account the total costs incurred by the hospital for each account analyzed.

For the years ended September 30, 2012 and 2011, bad debt expense, at charges, was $32.6 million and $26.4 million, respectively. The bad debt expense is multiplied by the ratio of cost to charges for purposes of inclusion in the total uncompensated care amount identified above.

The Connecticut Disproportionate Share Hospital Program ("CDSHP") was established to provide funds to hospitals for the provision of uncompensated care and is funded, in part, by a 1% assessment on hospital net inpatient service revenue. During the years ended September 30, 2012 and 2011, the Hospital received $73.2 million and $33.0 million, respectively, in CDSHP distributions, of which approximately $51.9 million and $23.0 million was related to charity care. The Hospital made payments into the CDSHP of $56.5 million and $14.1 million for the years ended September 30, 2012 and 2011, respectively, for the 1% assessment.

3. Uncompensated Care and Community Benefit Expense (continued)

Additionally, the Hospital provides benefits for the broader community which includes services provided to other needy populations that may not qualify as poor but need special services and support. Benefits include the cost of health promotion and education of the general community, interns and residents, health screenings, and medical research. The benefits are provided through the community health centers, some of which service non-English speaking residents, disabled children, and various community support groups. The Hospital voluntarily assists with the direct funding of several City of New Haven programs, including an economic development program and a youth initiative program.

In addition to the quantifiable services defined above, the Hospital provides additional benefits to the community through its advocacy of community service by employees. The Hospital's employees serve numerous organizations through board representation, membership in associations and other related activities. The Hospital also solicits the assistance of other healthcare professionals to provide their services at no charge through participation in various community seminars and training programs.

4. Investments and Assets Limited as to Use

The composition of investments, including investments held by the Trust, amounts on deposit with trustee in debt service fund and assets limited as to use is set forth in the following table (in thousands):

	2012	2011
Money market funds	**$ 156,663**	$ 108,579
U.S. equity securities	**28,378**	11,113
U.S. equity securities –common collective trusts	**6,331**	33,319
International equity securities (a)	**40,019**	37,523
Fixed income:		
U.S. government	**87,329**	41,719
U.S. government – common collective trusts	**82,872**	58,205
International government (b)	**43,236**	31,704
Commodities	**676**	1,010
Hedge funds:		
Absolute return (c)	**48,614**	44,783
Long/short equity (d)	**12,205**	12,653
Real estate (e)	**9,905**	10,168
Interest in Yale University endowment pool (f)	**361,550**	278,719
Perpetual trusts (g)	**12,127**	10,906
Total	**$ 889,905**	$ 680,401

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

(a) Investments with external international equity and bond managers that are domiciled in the United States. Investment managers may invest in American or Global Depository Receipts (ADR, GDR) or in direct foreign securities.

(b) Investments with external commodities futures manager.

(c) Investment with external multi-strategy fund of funds manager investing in publicly traded equity and credit holdings which may be long or short positions.

(d) Investment with an external long-short equity fund of funds manager with underlying portfolio investments consisting of publicly traded equity positions.

(e) Investments with external direct real estate managers and fund of funds managers. Investment vehicles include both closed end REITs and limited partnerships.

(f) Yale University Endowment Pool maintains a diversified investment portfolio, through the use of external investment managers operating in a variety of investment vehicles, including separate accounts, limited partnerships and commingled funds. The pool combines an orientation to equity investments with an allocation to non-traditional asset classes such as an absolute return, private equity, and real assets.

(g) Investments consist of several domestic and international equity and fixed income mutual funds, REITs, commodities and money market funds. There is also an investment in a hedge fund of funds.

The Hospital's ownership percentage of the Trust was approximately 85.8% and 85.2% as of September 30, 2012 and 2011, respectively. The Hospital's prorata portion of the Trust's investments are included above in the table.

Included in assets limited as to use at September 30, 2012 are funds to be used for the various renovations and expansion at the Hospital which was funded by the Series M bond (see Note 7). These funds consisted of money market funds of approximately $13.3 million and $60.7 million at September 30, 2012 and 2011, respectively.

5. Endowment

The Hospital's endowment includes donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

5. Endowment (continued)

The Hospital has interpreted the Connecticut Uniform Prudent Management of Institutional Funds Act ("CUPMIFA") 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 Hospital classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment related to the Hospital's beneficial interest in perpetual trusts 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 Hospital in a manner consistent with the standard of prudence prescribed by CUPMIFA. In accordance with CUPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the Hospital and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the Hospital; and (7) the investment and spending policies of the Hospital.

Changes in endowment net assets for the year ended September 30, 2012 are as follows (in thousands):

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 37,338	$ 25,523	$ 62,861
Investment return:			
Investment income	249	–	249
Net appreciation (realized and unrealized)	6,213	–	6,213
Total investment return	6,462	–	6,462
Contributions	2	–	2
Appropriation of endowment assets for expenditure	(7,124)	–	(7,124)
Other changes:			
Change in value of beneficial interest trusts	–	1,221	1,221
Endowment net assets, end of year	$ 36,678	$ 26,744	$ 63,422

5. Endowment (continued)

Changes in endowment net assets for the year ended September 30, 2011 are as follows (in thousands):

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 41,829	$ 26,256	$ 68,085
Investment return:			
Investment income	443	–	443
Net appreciation (realized and unrealized)	3,104	–	3,104
Total investment return	3,547	–	3,547
Contributions	2	–	2
Appropriation of endowment assets for expenditure	(8,040)	–	(8,040)
Other changes:			
Change in value of beneficial interest trusts	–	(733)	(733)
Endowment net assets, end of year	$ 37,338	$ 25,523	$ 62,861

	September 30 2012	2011
	(*in thousands*)	
The portion of perpetual endowment funds subject to a time restriction under CUPMIFA:		
Without purpose restrictions	**$ 8,297**	$ 8,478
With purpose restrictions	**28,381**	28,860
Total endowment funds classified as temporarily restricted net assets	**$ 36,678**	$ 37,338

Return Objectives and Risk Parameters

The Hospital has adopted investment and spending policies for endowed assets that attempt to provide a predictable stream of funding to programs supported by its endowment. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity.

Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that over time provide a rate of return that meets the spending policy objectives adjusted for inflation. Actual returns in any given year may vary from this amount.

5. Endowment (continued)

Strategies Employed for Achieving Objectives

To satisfy its long-term rate of return objectives, the Hospital 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 Hospital targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Hospital has a policy of appropriating for distribution each year based on a combination of the weighted average of the prior year spending adjusted for inflation and the amount that would have been spent using a predetermined percentage of the current market value of the endowment fund. In establishing this policy, the Hospital considered the long-term expected return on its endowment.

6. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes (in thousands):

	September 30	
	2012	**2011**
Plant improvement and expansion	**$ 568**	$ 441
Specific hospital operations, teaching, research, free care, and training	**45,458**	43,506
	$ 46,026	$ 43,947

Permanently restricted net assets of approximately $26.7 million and $25.5 million at September 30, 2012 and 2011, respectively, consist of donor restricted endowment principal and beneficial interests in perpetual trusts. The income generated from permanently restricted funds is expendable for purposes designated by donors, including research, free care, health care, and other services.

7. Debt

A summary of debt is as follows (in thousands):

	September 30 2012	2011
Hospital revenue bonds financed with the State of Connecticut Health and Educational Facilities Authority ("CHEFA"):		
Series J (5.12% effective interest rate)	**$ 159,110**	$ 164,295
Series K (3.11% effective interest rate)	**94,955**	98,305
Series L (3.68% effective interest rate)	**107,460**	107,460
Series M (5.24% effective interest rate)	**100,175**	101,825
Bank line of credit payable	**187,000**	–
Bank line of credit payable	**25,000**	–
Capital lease obligation – November 2010	**53,827**	55,309
Capital lease obligation – December 2010	**53,702**	55,082
Bank note payable (0.08% effective interest rate)	**40,000**	40,000
	821,229	622,276
Add: premium	**6,467**	7,322
Less: current portion	**(100,490)**	(13,047)
	$ 727,206	$ 616,551

In September 2006, the Hospital issued Series J revenue bonds totaling approximately $280.9 million. The proceeds, including a premium of approximately $10.1 million, were used to finance a portion of the construction costs of the Cancer Hospital, and to pay for bond issuance costs. The bond premium was being amortized and was included in capitalized interest through March 2010. As of the opening of the Cancer Hospital, the bond premium was amortized in the statement of operations. The Series J revenue bonds were issued in three sub-series as follows: (1) Series J-1, approximately $174.4 million, consisting of approximately $83.7 million of serial bonds and approximately $90.7 million in term bonds bearing interest at 5% per annum; (2) Series J-2, approximately $40.0 million of revenue bonds bearing interest at 3.65% at September 30, 2007; (3) Series J-3, approximately $66.5 million of revenue bonds bearing interest 3.70% at September 30, 2007. Series J-2 and J-3 revenue bonds were refunded during the year ended September 30, 2008 by the issuance of Series L revenue bonds.

In May 2008, the Hospital issued Series K and Series L revenue bonds totaling approximately $216.6 million. The Series K revenue bonds were issued as Variable Rate Demand Bonds ("VRDBs") in two sub-series, Series K-1 and K-2, approximately $54.6 million each, with an effective rate of 1.1% in 2011 and 2010. The proceeds from the Series K issuance were used to

7. Debt (continued)

refund the Series I revenue bonds. The Series L revenue bonds were issued as VRDBs in two sub-series, Series L-1 and L-2, approximately $53.7 million each, with an effective rate of 0.8% in 2012 and 2011. The proceeds from the Series L issuance were used to refund the Series J-2 and J-3 revenue bonds.

Both the Series K and Series L VRDBs are required to be supported by letter of credit facilities ("LOCs") which have been executed with two financial institutions. These LOCs are scheduled to expire on May 2, 2016 and May 14, 2016.

In December 2010, the Hospital issued Series M revenue bonds totaling approximately $104.4 million. The proceeds, including a premium of approximately $1.0 million, are being used to finance costs for the expansion and renovations to the Adult Emergency Department, the purchase and installation of machinery and equipment, various renovations and improvements to the Hospital's infrastructure, and to pay for bond issuance costs. The bond premium is being amortized and is included in capitalized interest. The Series M revenue bonds were issued as one series consisting of approximately $33.9 million of serial bonds bearing interest at 4.69%, and approximately $17.6 million, $17.8 million, and $35.1 million in term bonds bearing interest at 5.25%, 5.75%, and 5.50%, respectively, per annum.

On August 30, 2011, the Hospital entered into a loan agreement with Bank of America, N.A. (the "Bank") for $40.0 million. The Hospital agreed to repay the Bank the aggregate principal amount in five equal annual payments of $8.0 million, beginning on October 1, 2012. The loan bears interest at a rate equal to LIBOR plus 0.50% per annum with an option to convert to a fixed rate loan upon formal notification to the Bank, which may include a portion of or the total outstanding loan balance at the time notification is made.

In July 2012, the Hospital entered into a line of credit with the Bank in the amount of $27.0 million which was subsequently increased to $187.0 million upon the execution of the HSR asset purchase agreement. In July 2012, the Hospital drew the unconditional loan of $27.0 million to outfit a new facility. In September 2012, the Hospital drew the remaining $160.0 million to fund the acquisition of HSR. The line of credit requires the Hospital to repay the Bank in 24 equal monthly installments commencing on August 1, 2013. The full amount of the remaining balance is due on July 12, 2015. This obligation bears interest at a rate equal to LIBOR plus 0.45% per annum.

7. Debt (continued)

In September 2012, the Hospital drew on its $50.0 million line of credit with the U.S. Bank, established in January 2012, in the amount of $25.0 million. The U.S. Bank line of credit requires repayment of the aggregate principal amount on the 364th day subsequent to the advance. This obligation bears interest at a rate equal to LIBOR plus 0.50% per annum.

The terms of the various financing arrangements between CHEFA and the Hospital, the financial institutions providing the LOCs and the Hospital, and the Bank and the Hospital provide for financial covenants regarding the Hospital's debt service coverage ratio, liquidity ratio, and debt to capitalization ratio, among others. As of September 30, 2012 and 2011, the Hospital was in compliance with these covenants.

Sinking fund installment amounts are to be made in accordance with the Series J, K, L, and M financing agreements. Required monthly payments on the revenue bonds by the Hospital to a trustee are in amounts sufficient to provide for the payments of principal, interest, and sinking fund installments, in accordance with the terms of the agreements, and certain other annual costs of CHEFA.

Scheduled principal payments on all debt, including capital lease obligations, are as follows (in thousands):

	Debt	Capital Lease Obligations
2013	$ 45,198	$ 58,757
2014	204,512	4,647
2015	19,445	4,821
2016	19,945	4,879
2017	20,425	4,879
Thereafter	404,175	63,810
	$ 713,700	141,793
Less interest		(34,264)
Total capital lease obligation		$ 107,529

Capitalized interest at September 30, 2012 and 2011 totaled $26.9 million and $24.9 million, respectively.

7. Debt (continued)

The Hospital has entered into interest rate swap agreements with financial institutions related to the Hospital's Series K and Series L debt, and future obligations. The Series K and Series L swaps were carried over as part of the refunding of the Series I and Series J debt. On September 20, 2012, the Hospital entered into a Forward Starting Interest Rate swap, a LIBOR Swap Rate Lock and a SIFMA Rate Lock swap with two different counterparties. The agreements require the Hospital to pay a fixed rate and receive a floating rate based on LIBOR or SIFMA. The change in market value, as well as the net interest paid or received under the swap agreement, for the Series J/Series L swap has been capitalized as part of the interest costs related to construction of the Cancer Hospital until construction was complete. Once the Cancer Hospital became operational these amounts were recorded in the statements of operations.

The swap agreements fix the interest rate at a level viewed as desirable by the Hospital. Such agreements expose the Hospital to credit risk in the event of non-performance by the counterparties, some of which is collateralized. At September 30, 2012 and 2011, the fair value of all swap agreements based on current interest rates was approximately $39.3 million and $31.9 million, respectively, representing a payable to the counterparties (recorded in other long-term liabilities).

For the Series K swap, there was an unfavorable change in fair value of approximately $0.9 million for the years ended September 30, 2012 and 2011 which was recorded in the excess of revenue over expenses. As a result of the unfavorable change in market value of the Series K swap, $4.6 million and $4.2 million has been collateralized by the Hospital and is being held by the financial institution as of September 30, 2012 and 2011, as required by the swap agreement.

For the Series L swaps, there was an unfavorable change in fair value of approximately $2.0 million and $3.5 million for the years ended September 30, 2012 and 2011, respectively, which was recorded in excess of revenue over expenses. No collateral was required under the Series L swap agreement for the years ended September 30, 2012 and 2011.

For the Forward Starting Interest Rate swap, the LIBOR Swap Rate Lock and the SIFMA Rate Lock swaps, there was an unfavorable change in fair value of $1.0 million, $1.9 million, and $1.6 million, respectively, for the year ended September 30, 2012, which was recorded in excess of revenue over expenses.

7. Debt (continued)

The following table summarizes the Hospital's interest rate swap agreements (in thousands):

Swap Type	Expiration Date	Hospital Receives	Hospital Pays	Notional Amount at September 30, 2012	2011
Series K – Fixed to Floating	July 1, 2025	LIBOR	3.11%	**$ 63,977**	$ 66,269
Series L – Fixed to Floating	July 1, 2036	LIBOR	3.68%	**44,505**	44,505
Forward Starting Interest Rate Swap	July 1, 2053	67% of LIBOR	2.84%	**50,000**	–
LIBOR Swap Rate Lock	July 1, 2043	LIBOR	2.73%	**92,000**	–
SIFMA Rate Lock	July 1, 2048	SIFMA	2.66%	**50,000**	–
				$ 300,482	$ 110,774

For the years ended September 30, 2012 and 2011, the Hospital paid approximately $16.5 million and $15.8 million, respectively, for interest related to long-term debt, exclusive of the swap agreements.

Arbitrage rules apply for Series J-1 and Series M tax-exempt debt. The rules require that, in specified circumstances, earnings from the investment of tax-exempt bond proceeds which exceed the yield on the bonds must be remitted to the Federal government.

The Hospital has entered into a contract to lease space in a building adjacent to the Hospital. The Hospital's rental obligation commenced December 2009. This lease has a term of twenty years from the commencement date with the option to extend the lease for four successive terms of ten years. Rental payments will increase by 5% every five years. The Hospital is also subject to additional rent for its share of expenses, as defined in the contract. The Hospital has the option to purchase the property at the end of the fifth, tenth, or twentieth years or at the end of each of the first three ten-year extension periods.

The Hospital has entered into an agreement to lease space in a building located at 2 Howe Street, New Haven, Connecticut. The Hospital's rental obligation commenced during the first quarter of fiscal 2010. The Hospital will lease these spaces for three years after which the Hospital has the obligation to purchase the property for approximately $53.6 million.

Assets recorded under the capital lease obligations totaled $115.1 million as of September 30, 2012 and 2011. Accumulated depreciation for the capital lease obligations totaled $8.0 million and $4.2 million at September 30, 2012 and 2011, respectively.

8. Pensions and Postretirement Benefits

The Hospital has qualified and non-qualified defined benefit pension plans covering substantially all employees and executives. The benefits provided are based on age, years of service and compensation. The Hospital's policy is to fund the pension benefits with at least the minimum amounts required by the Employee Retirement Income Security Act of 1974.

The employees formerly employed by SRHS will receive credit for such past service solely for purposes of determining such employee's eligibility to participate in the qualified defined benefit pension plan and vesting under this plan, but not for purposes of establishing an opening accumulation account or for any other purpose under this plan.

The Hospital also sponsors a contributory 403(b) plan, covering substantially all employees. The Hospital's contributions for the 403(b) plan are determined based on employee contributions and years of service. The Hospital contributed approximately $11.9 million and $10.9 million for the years ended September 30, 2012 and 2011, respectively. The Hospital maintains a Section 457 non-qualified deferred compensation plan. Contributions are made on a pre-tax basis. The balances recorded at September 30, 2012 and 2011 in other assets and other long-term liabilities were $21.7 million and $18.4 million, respectively. The employees formerly employed by SRHS shall receive credit for such past service solely for purposes of determining such employee's eligibility to participate in the contributory 403(b) plan and vesting under this plan but not for any other purpose under this plan.

The Hospital also provides certain health care and life insurance benefits upon retirement to substantially all its employees. The Hospital's policy is to fund these annual costs as they are incurred from the general assets of the Hospital. The estimated cost of these postretirement benefits is actuarially determined and accrued over the employees' service periods.

Included in unrestricted net assets at September 30, 2012 and 2011 are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service credit of $0.1 million and $0.3 million, respectively, and unrecognized actuarial losses of $183.6 million and $129.7 million, respectively. The prior service credit 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 are $0.6 million and $9.6 million, respectively.

8. Pensions and Postretirement Benefits (continued)

The following table sets forth the change in benefit obligation, change in plan assets, and the reconciliation of underfunded status of the Hospital's defined benefit plans as of September 30, 2012 and 2011 (in thousands):

	Defined Benefit Pension Plans		**Postretirement Benefits Plan**	
	2012	**2011**	**2012**	**2011**
Change in benefit obligation:				
Benefit obligation at prior measurement date	**$ 405,642**	$ 374,050	**$ 63,687**	$ 58,103
Service cost	**22,106**	18,385	**3,442**	3,092
Interest cost	**18,803**	17,407	**3,183**	3,014
Actuarial loss	**53,111**	13,409	**10,588**	818
Benefits paid	**(24,189)**	(17,609)	**(1,270)**	(1,340)
Benefit obligation at current measurement date	**475,473**	405,642	**79,630**	63,687
Change in plan assets:				
Fair value of assets at prior measurement date	**225,895**	228,281	**–**	–
Actual return on plan assets	**25,511**	2,338	**–**	–
Employer contributions	**44,735**	12,885	**1,270**	1,340
Benefits paid	**(24,189)**	(17,609)	**(1,270)**	(1,340)
Fair value of assets at current measurement date	**271,952**	225,895	**–**	–
Accrued benefit cost	**$ (203,521)**	$ (179,747)	**$ (79,630)**	$ (63,687)

Benefit Obligation and Assumptions

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the defined benefit plans were as follows (in thousands):

	September 30	
	2012	**2011**
Projected benefit obligation	**$ (475,473)**	$ (405,642)
Accumulated benefit obligation	**(398,939)**	(342,050)
Fair value of plan assets	**271,952**	225,895

8. Pensions and Postretirement Benefits (continued)

At September 30, 2012 and 2011, the underfunded status of the qualified defined benefit pension plan was approximately $154.1 million and $136.8 million, respectively, and that of the non-qualified defined benefit pension plan was approximately $49.4 million and $43.0 million, respectively. Additionally, there are assets limited as to use of approximately $64.7 million and $58.4 million, which are available to satisfy the obligations of the non-qualified defined benefit pension plan at September 30, 2012 and 2011, respectively.

The net periodic benefit cost for the years ended September 30, 2012 and 2011 is as follows (in thousands:

	Defined Benefit Pension Plans		**Postretirement Benefits Plan**	
	2012	**2011**	**2012**	**2011**
Service cost	**$ 22,106**	$ 18,385	**$ 3,442**	$ 3,092
Interest cost	**18,803**	17,407	**3,183**	3,014
Expected return on plan assets	**(20,521)**	(19,350)	–	–
Amortization of prior service cost	**(462)**	(462)	**259**	264
Recognized net actuarial loss	**4,738**	2,711	–	–
Net periodic benefit cost	**$ 24,664**	$ 18,691	**$ 6,884**	$ 6,370

Weighted-average assumptions and dates used to determine benefit obligations at September 30, 2012 and 2011 are as follows:

	Defined Benefit Pension Plans		**Postretirement Benefits Plan**	
	2012	**2011**	**2012**	**2011**
Discount rate for determining benefit obligations at year-end, qualified plan	**3.60%**	4.80%	**4.00%**	5.10%
Discount rate for determining benefit obligations at year end, non-qualified plan	**4.00**	5.10	–	–
Rate of compensation increase	**5.00**	5.00	–	–

8. Pensions and Postretirement Benefits (continued)

Weighted-average assumptions used to determine net periodic benefit cost for the years ended September 30, 2012 and 2011 are as follows:

	Defined Benefit Pension Plans		Postretirement Benefits Plan	
	2012	**2011**	**2012**	**2011**
Discount rate for determining net periodic benefit cost at year-end, qualified plan	**4.80%**	4.80%	**5.10%**	**5.30%**
Discount rate for determining net periodic benefit cost at year end, non-qualified plan	**5.10**	5.30	–	–
Expected rate of return on plan assets	**7.75**	7.75	–	–
Rate of compensation increase	**5.00**	5.00	–	–

For measurement purposes relating to the postretirement benefits plan, a 7.0% and 8.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for fiscal 2012 and fiscal 2011, respectively. Rates are assumed to decline to 4.0% through fiscal 2014.

Assumed health care cost trend rate assumptions have a significant effect on the amounts reported. A 1% change in the assumed healthcare cost trend rate would have the following effects (in thousands):

	1% Increase	**1% Decrease**
Effect on total of service and interest cost components	$ 13	$ (15)
Effect on postretirement benefit obligation	142	(144)

8. Pensions and Postretirement Benefits (continued)

The asset allocation of the Hospital's qualified pension plan at September 30, 2012 and 2011 was as follows:

	Target Allocation	Percentage of Plan Assets	
Asset Category	**2013**	**2012**	**2011**
Equity securities	**36%**	**42%**	41%
Debt securities	**26**	**27**	28
Real assets	**14**	**11**	12
All other assets	**24**	**20**	19
Total	**100%**	**100%**	100%

The pension assets carried at fair value, as of September 30, 2012 and 2011 are classified in the following tables (see Footnote 14 for description) (in thousands):

	September 30, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Money market funds	**$ 18,306**	**$ –**	**$ –**	**$ 18,306**
U.S. equity securities	**53,150**	**–**	**–**	**53,150**
International equity securities	**58,819**	**–**	**–**	**58,819**
Fixed income:				
U.S. government	**53,392**	**–**	**–**	**53,392**
International government	**12,985**	**6,425**	**–**	**19,410**
Commodities	**5,469**	**–**	**6,127**	**11,596**
Private Equity	**–**	**–**	**509**	**509**
Hedge funds:				
Absolute return	**–**	**32,115**	**–**	**32,115**
Long/short equity	**–**	**7,871**	**–**	**7,871**
Real estate	**–**	**–**	**16,784**	**16,784**
Total investments	**$ 202,121**	**$ 46,411**	**$ 23,420**	**$ 271,952**

8. Pensions and Postretirement Benefits (continued)

	September 30, 2011 Level 1	Level 2	Level 3	Total
Money market funds	$ 4,673	$ –	$ –	$ 4,673
U.S. equity securities	47,070	–	–	47,070
International equity securities	45,118	–	–	45,118
Fixed income:				
U.S. government	51,551	–	–	51,551
International government	13,260	–	–	13,260
Commodities	4,923	–	5,745	10,668
Private Equity	–	–	331	331
Hedge funds:				
Absolute return	–	29,362	–	29,362
Long/short equity	–	8,235	–	8,235
Real estate	–	–	15,627	15,627
Total investments	$ 166,595	$ 37,597	$ 21,703	$ 225,895

The following is a rollforward of the pension assets classified as level 3 of the valuation hierarchy as described in Note 15:

	Commodities	Private Equity	Real Estate	Total
Fair value at September 30, 2010	$ 5,852	$ –	$ 14,599	$ 20,451
2011 Realized and unrealized gains and losses	686	–	3,049	3,735
2011 Purchases, sales, transfers, issuances and settlements, net	(793)	331	(2,021)	(2,483)
Fair value at September 30, 2011	**5,745**	**331**	**15,627**	**21,703**
2012 Realized and unrealized gains and losses	**18**	**(57)**	**206**	**167**
2012 Purchases, sales, transfers, issuances and settlements, net	**364**	**235**	**951**	**1,550**
Fair value at September 30, 2012	**$ 6,127**	**$ 509**	**$ 16,784**	**$ 23,420**

The Hospital's investment strategy for its pension assets balances the liquidity needs of the pension plan with the long-term return goals necessary to satisfy future pension obligations. The target asset allocation seeks to capture the equity premium granted by the capital markets over the long-term, while ensuring security of principal to meet near-term expenses and obligations through the fixed income allocation. The allocation of the investment pool to various sectors of the markets is designed to reduce volatility in the portfolio. The Hospital's pension portfolio

8. Pensions and Postretirement Benefits (continued)

return assumption of 7.75% is based on the targeted weighted-average return of comparative market indices for the asset classes represented in the portfolio and discounted for pension expenses. The actual return on assets of the pension plan for the years ended September 30, 2012 and 2011 was 11.1% and 2.7 %, respectively.

The future cash flows of the Hospital relative to retirement benefits are expected to be as follows (in thousands):

	Defined Benefit Pension Plans	Postretirement Benefits Plan
Estimated benefit payments related to years ending September 30:		
2013	$ 35,244	$ 2,521
2014	35,199	2,832
2015	36,398	3,063
2016	36,570	3,316
2017	38,078	3,646
2018 to 2022	202,611	24,096

The Hospital expects to contribute approximately $41.6 million for pension benefits and $2.5 million for postretirement benefits payments in fiscal 2013.

9. Professional Liability Insurance

In 1978, the Hospital and a number of other academic medical centers formed the Medical Centre Insurance Company, Ltd (the "Captive") to insure for professional and comprehensive general liability risks. In 1997, the Captive formed MCIC Vermont, Inc. to write direct insurance for the professional and general liability risks of the shareholders. Since 1997, the Captive has acted as a reinsurer for varying levels of per claim limit exposure. MCIC Vermont, Inc. has reinsurance coverage from outside reinsurers for amounts above the per claim limits. Premiums are based on modified claims made coverage and are actuarially determined based on actual experience of the Hospital, the Captive and MCIC Vermont, Inc.

In fiscal 1998, the Hospital entered into a purchase and sales management agreement with YNHHSC that transferred the Hospital's participation in the Captive to YNHHSC for its book value as calculated by the Captive. Under the terms of the agreement, the Hospital retains certain elements of control and assumes limited risk associated with the ongoing operation of the Captive. The Hospital pays insurance premiums to YNHHSC.

9. Professional Liability Insurance (continued)

Additionally, because the purchase and sales management agreement entered into with YNHHSC in 1998 meet criteria for deposit accounting, the Hospital recorded an actuarially determined liability for IBNR professional and general liabilities with an offsetting deposit (asset) of an equal amount (approximately $11.8 million).

The estimate for modified claims-made professional liabilities and the estimate for incidents that have been incurred but not reported aggregated approximately $84.5 million and $89.0 million at September 30, 2012 and 2011, respectively for the Hospital. The undiscounted estimate for incidents that have been incurred but not reported aggregated approximately $29.7 million and $30.4 million for the Hospital at September 30, 2012 and 2011, respectively, and is included in professional insurance liabilities in the accompanying consolidated statements of financial position at the actuarially determined present value of approximately $28.5 million and $25.4 million, respectively, based on a discount rate of 3.0% and 3.5% for the years ended September 30, 2012 and 2011, respectively.

The Hospital has recorded related insurance recoveries receivable of approximately $56.0 million and $63.6 million at September 30, 2012 and 2011, respectively, in consideration of the expected insurance recoveries for the total discounted modified claims-made insurance. The current portion of professional liabilities and the related insurance receivable represents an estimate of expected settlements and insurance recoveries over the next 12 months.

Lukan, the Hospital sponsored professional liability program, continues to manage all incidents and claims reported to Lukan prior to the acquisition of SRHS, as well as extending professional liability coverage for post acquisition risks to certain affiliated community clinicians.

Prior to the acquisition of SRHS, Caritas provided excess professional liability and general liability insurance to SRHS and their employed clinicians. Caritas continues to manage all incidents and claims reported prior to the acquisition of SRHS.

Caritas and Lukan have recorded the undiscounted estimate for claims-made professional liabilities and the estimate for incidents that have been incurred but not reported aggregated of approximately $36.6 million at September 30, 2012 and are included in professional liabilities in the accompanying consolidated statements of financial position.

9. Professional Liability Insurance (continued)

The Hospital's estimates for professional insurance liabilities are based upon complex actuarial calculations which utilize factors such as historical claims experience for the Hospital and related industry factors, trending models, estimates for the payment patterns of future claims and present value discount factors. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Revisions to estimated amounts resulting from actual experience differing from projected expectations are recorded in the period the information becomes known or when changes are anticipated.

10. Commitments and Contingencies

Leases

The Hospital leases certain office, clinical and parking spaces under non-cancelable operating leases that range in terms ending in 2013 through 2024. Future minimum lease payments under these leases are as follows (in thousands):

2013	$ 12,419
2014	10,929
2015	8,180
2016	7,448
2017	6,350
Thereafter	18,018
	$ 63,344

The Hospital incurred net rent and parking expense under these leases of approximately $10.9 million and $10.1 million for each of the years ended September 30, 2012 and 2011, respectively.

Cancer Hospital

The Hospital has a shared facilities and services agreement with the University in connection with the Cancer Hospital which is recorded as deferred revenue. Deferred revenue, from this agreement, at September 30, 2012 and 2011 was $46.6 million and $48.3 million, respectively.

10. Commitments and Contingencies (continued)

Litigation

Various lawsuits and claims arising in the normal course of operations are pending or are in progress against the Hospital. Such lawsuits and claims are either specifically covered by insurance as explained in Note 9 or are deemed to be immaterial. While the outcomes of the lawsuits and claims cannot be determined at this time, management believes that any loss which may arise from these will not have a material adverse effect on the financial position or changes in net assets of the Hospital.

The Hospital has received requests for information from certain governmental agencies relating to, among other things, patient billings. These requests cover several prior years relating to compliance with certain laws and regulations. Management is cooperating with those governmental agencies in their information requests and ongoing investigations. The ultimate results of those investigations, including the impact on the Hospital, cannot be determined at this time.

11. Functional Expenses

The Hospital provides general acute health care services to residents within its geographic area. Net expenses related to providing these services are as follows (in thousands):

	Year Ended September 30	
	2012	**2011**
Health care services	**$ 1,422,822**	$ 1,234,794
General and administrative	**231,622**	201,013
	$ 1,654,444	$ 1,435,807

12. Related Party Transactions

The Hospital provided facility space and certain services to related parties as follows (in thousands):

	Year Ended September 30 2012	Year Ended September 30 2011
Recovery of expenses:		
YNHHSC:		
Facility rental	**$ 2,883**	$ 2,736
Shared services	**230**	2,322
Other	**–**	1,190
	$ 3,113	$ 6,248
Bridgeport Hospital:		
Resident fees	**$ 2,379**	$ 2,444
Other	**1,107**	1,000
	$ 3,486	$ 3,444
Ambulatory Services Corporation:		
Salaries and benefits	**$ 5,654**	$ 4,993
Other	**336**	185
	$ 5,990	$ 5,178

YNHHSC is the sole member of Bridgeport Hospital Healthcare Services, Inc., which is the sole member of Bridgeport Hospital.

YNHNC is the parent organization of Yale-New Haven Ambulatory Services Corporation, a Connecticut, non-stock taxable corporation.

The Hospital purchased certain services from YNHHSC as follows (in thousands):

	Year Ended September 30 2012	Year Ended September 30 2011
Operating expenses:		
Professional and general liability insurance	**$ 20,948**	$ 20,654
Information systems	**37,673**	18,805
System business office	**17,739**	15,198
Other business services	**67,613**	47,529
	$ 143,973	$ 102,186

12. Related Party Transactions (continued)

Amounts receivable from and payable to related organizations included in other receivables, other assets, accounts payable and other long-term liabilities, respectively, in the accompanying balance sheets are as follows (in thousands):

	September 30	
	2012	**2011**
Other receivables:		
YNHHSC	**$ 2,283**	$ 2,974
Bridgeport Hospital	**–**	362
York Enterprises, Inc.	**482**	133
Ambulatory Services Corporation	**369**	894
Greenwich Hospital	**560**	23
Northeast Medical Group, Inc.	**–**	340
Other assets:		
YNH Care Continuum Corporation	**4,000**	–
Ambulatory Services Corporation	**12,500**	–
	$ 20,194	$ 4,726
Accounts payable:		
YNHHSC	**$ 28,503**	$ 23,960
Greenwich Hospital	**–**	51
Bridgeport Hospital	**1,501**	–
YNH Network Corporation	**613**	–
York Enterprises, Inc.	**16**	19
Northeast Medical Group Inc.	**2,912**	–
YNH Care Continuum Corporation	**407**	–
Other long-term liabilities:		
YNHHSC	**42,385**	38,162
	$ 76,337	$ 62,192

The Hospital maintains certain investments for YNHHSC employees that participate in the Hospital's sponsored benefit plans. The costs associated with the YNHHSC employees that participate in benefit plans are recovered by the Hospital.

The Hospital funds certain capital assets purchased by YNHHSC. Included in prepaid expenses and other assets were approximately $13.9 million and $49.8 million, respectively, at September 30, 2012 and approximately $2.7 million and $30.7 million, respectively, at September 30, 2011.

12. Related Party Transactions (continued)

Additionally, for the years ended September 30, 2012 and 2011, the Hospital funded YNHHSC approximately $9.0 million and $12.0 million, respectively, as part of its participation in the New Clinical Program Development Corporation ("NCPDC"). The NCPDC was established for the purpose of funding and supporting clinical research and clinical programs. The NCPDC Board approves the funding of initiatives.

13. Other Revenue

Other revenue consisted of the following (in thousands):

	Year Ended September 30	
	2012	**2011**
Cafeteria and vending	**$ 7,756**	$ 7,129
Contributions	**2,960**	2,667
Parking income	**4,087**	3,555
Net assets released from restrictions for operations	**2,962**	5,003
Net assets released from restrictions for free care	**889**	782
Net assets released from restrictions for medical research and clinical programs	**12,804**	16,195
Grants	**8,314**	7,432
Electronic health records incentive payment	**2,649**	–
Other	**5,263**	3,877
	$ 47,684	$ 46,640

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act ("HITECH"). The provisions were designed to increase the use of electronic health record ("EHR") technology and establish the requirements for a Medicare and Medicaid incentive payment program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology. In subsequent years, providers must demonstrate meaningful

13. Other Revenue (continued)

use of such technology to qualify for additional Medicaid incentive payments. Hospitals that do not successfully demonstrate meaningful use of EHR technology are subject to payment penalties or downward adjustments to their Medicare payments beginning in federal fiscal year 2015.

The Hospital uses a grant accounting model to recognize revenue for the Medicare and Medicaid EHR incentive payments. Under this accounting policy, EHR incentive payment revenue is recognized when the Hospital is reasonably assured that the EHR meaningful use criteria for the required period of time were met and that the grant revenue will be received. EHR incentive payment revenue totaling $2.6 million for Medicaid for the year ended September 30, 2012, is included in other revenue in the accompanying 2012 consolidated statement of operations. Income from incentive payments is subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated. Additionally, the Hospital's attestation of compliance with the meaningful use criteria is subject to audit by the federal government.

14. Non-Operating Gains and Losses, Net

Non-operating gains and losses consisted of the following (in thousands)

	Year Ended September 30	
	2012	**2011**
Income from investments, donations and other, net	**$ 5,959**	$ 21,138
Change in unrealized gains and losses on investments	**47,932**	(1,949)
Change in fair value of swaps, including counterparty payments	**(12,610)**	(9,781)
Acquisition costs related to Saint Raphael Healthcare System	**(22,103)**	(6,051)
Medical residents FICA tax refund	**4,920**	10,915
	$ 24,098	$ 14,272

15. Fair Value Measurements

In determining fair value, the Hospital utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Hospital also considers nonperformance risk in the overall assessment of fair value.

15. Fair Value Measurements (continued)

ASC 820-10, *Fair Value Measurements,* establishes a three tier valuation hierarchy for fair value disclosure purposes. This hierarchy is based on the transparency of the inputs utilized for the valuation. The three levels are defined as follows:

- **Level 1:** Quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities. This established hierarchy assigns the highest priority to Level 1 assets.

- **Level 2:** Observable inputs that are based on data 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 Level 3 inputs are assigned the lowest priority.

Financial assets carried at fair value as of September 30, 2012 are classified in the following table in two of the three categories described above (in thousands):

	September 30, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	**$ 64,557**	**$ –**	**$ –**	**$ 64,557**
Money market funds	**156,663**	**–**	**–**	**156,663**
U.S. equity securities	**28,378**	**–**	**–**	**28,378**
International equity securities	**40,019**	**–**	**–**	**40,019**
Fixed income				
U.S. government	**87,329**	**–**	**–**	**87,329**
International government	**26,227**	**17,009**	**–**	**43,236**
Interest in Yale University endowment pool	**–**	**–**	**361,550**	**361,550**
Investments at fair value	**$ 403,173**	**$ 17,009**	**$ 361,550**	**781,732**
Common collective trusts				**89,203**
Alternative investments				**71,400**
Perpetual trusts				**12,127**
Investments not at fair value				**172,730**
Total investments				**$ 954,462**
Liabilities:				
Interest rate swaps	**$ –**	**$(39,269)**	**$**	**$ (39,269)**

15. Fair Value Measurements (continued)

Financial assets carried at fair value as of 2011 are classified in the following table in two of the three categories described above (in thousands):

	September 30, 2011			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 65,883	$ –	$ –	$ 65,883
Money market funds	108,579	–	–	108,579
U.S. equity securities	11,113	–	–	11,113
International equity securities	37,523	–	–	37,523
Fixed income				
U.S. government	41,719	–	–	41,719
International government	31,704	–	–	31,704
Interest in Yale University endowment pool	–	–	278,719	278,719
Investments at fair value	$ 296,521	$ –	$ 278,719	575,240
Common collective trusts				91,524
Alternative investments				68,614
Perpetual trusts				10,906
Investments not at fair value				171,044
Total investments				$ 746,284
Liabilities:				
Interest rate swaps	$ –	$ (31,951)	$	$ (31,951)

The following is a rollforward of assets classified as level 3 of the valuation hierarchy:

Interest in Yale University Endowment Pool:	
Fair value at September 30, 2010	$ 175,332
2011 Unrealized gains	15,641
2011 Purchases	87,746
Fair value at September 30, 2011	278,719
2012 Unrealized gains	38,570
2012 Purchases	44,261
Fair value at September 30, 2012	$ 361,550

The fair value of debt was approximately $741.7 million and $528.9 million at September 30, 2012 and 2011, respectively. The fair value of the capital leases was approximately $112.6 million and $118.7 million at September 30, 2012 and 2011, respectively.

15. Fair Value Measurements (continued)

The amounts reported in the table as detailed above do not include assets invested in the Hospital's defined benefit pension plan (see Note 8). In addition, included in the table above are investments at September 30, 2012 and 2011 in common collective trusts totaling approximately $89.2 million and $91.5 million, respectively, other alternative investments totaling approximately $71.2 million and $68.6 million, respectively, and perpetual trusts totaling approximately $12.1 million and $10.9 million, respectively, that are accounted for under the equity method of accounting (see Note 1). The interest rate swaps listed above are classified in the accompanying balance sheets as other long-term liabilities at September 30, 2012 and 2011.

The following is a summary of total investments as of September 30, 2012 with restrictions to redeem the investments at the measurement date, any unfunded capital commitments and investment strategies of the investees (in thousands):

Description of Investment	Carrying Value	Unfunded Commitment	Redemption Frequency	Notice Period	Funds Availability
Hedge funds:					
Long/short equity	$ 12,205	$ –	Annually	100 days	December 31
Absolute return	48,614	–	Annually	100 days	December 31
Real estate	9,905	3,507	N/A	N/A	N/A
Commodities	676	9,963	N/A	N/A	N/A

16. Medical Residents FICA Tax Refund

In March 2010, the Internal Revenue Service ("IRS") announced that, for periods ending before April 1, 2005, medical residents would be eligible for student exception of Federal Insurance Contributions Act ("FICA") taxes. Under the student exception, FICA taxes do not apply to wages for services performed by students employed by a school, college, or university where the student is pursuing a course of study. As a result, the IRS will allow refunds for institutions that file timely FICA refund claims and provide certain information to meet the requirements of perfection, established by the IRS, for their claims applicable to periods prior to April 1, 2005. Institutions are potentially eligible for medical resident FICA refunds for both the employer and employee portions of FICA taxes paid, plus statutory interest. For the year ended September 30, 2012 and 2011, the Hospital has recorded estimated net revenue of approximately $4.9 million and $10.9 million, respectively, in non-operating gains and losses, related to FICA medical resident refunds claims that have met the IRS refund requirements. At September 30, 2012 and 2011, the Hospital recorded a net receivable of approximately $18.2 million and $24.7 million, respectively included in other assets and a payable of approximately $13.8 million at September 30, 2012 and 2011 included in other long-term liabilities. The Hospital has established its estimate based on information presently available and this estimate is subject to change as the IRS adjudicates the claims.

17. Subsequent Events

Subsequent events have been evaluated through December 21, 2012, which is the date the financial statements were available to be issued. No events have occurred that require disclosure or adjustment of the financial statements.

Supplementary Information

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Report of Independent Auditors on Supplementary Information

Board of Trustees
Yale-New Haven Hospital, Inc. and Subsidiaries

We have audited the consolidated financial statements of Yale-New Haven Hospital, Inc. and Subsidiaries as of and for the years ended September 30, 2012 and 2011, and have issued our report thereon dated December 21, 2012 which contained an unqualified opinion on those financial statements. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating balance sheets consolidating statement of operations and change in net assets are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the 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 consolidated financial statements themselves and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statement as a whole.

Ernst + Young LLP

December 21, 2012

Yale-New Haven Hospital, Inc. and Subsidiaries

Consolidating Balance Sheet

September 30, 2012

(In Thousands)

	Hospital	Lukan	Caritas	Eliminations	Total
Assets					
Current assets:					
Cash and cash equivalents	$ 64,528	$ 20	$ 9	$ –	$ 64,557
Short-term investments	571,302	26,650	15,408	–	613,360
Accounts receivable for services to patients, net	202,909	–	–	–	202,909
Other receivables	48,257	384	–	–	48,641
Professional liabilities insurance recoveries receivable –current portion	15,739	–	–	–	15,739
Other current assets	47,328	20	46	–	47,394
Amounts on deposit with trustee in debt service fund	6,619	–	–	–	6,619
Total current assets	956,682	27,074	15,463	–	999,219
Assets limited as to use	105,688	–	–	–	105,688
Long-term investments	156,946	7,292	–	–	164,238
Deferred financing costs, less accumulated amortization	5,182	–	–	–	5,182
Professional liabilities insurance recoveries receivable –non-current	40,271	–	–	–	40,271
Goodwill	35,685	–	–	–	35,685
Other assets	188,494	–	1,331	(12,626)	177,199
Property, plant, and equipment:					
Land and land improvements	33,191	–	–	–	33,191
Buildings and fixtures	1,068,530	–	–	–	1,068,530
Equipment	426,413	–	–	–	426,413
	1,528,134	–	–	–	1,528,134
Less accumulated depreciation	601,670	–	–	–	601,670
	926,464	–	–	–	926,464
Construction in progress	63,603	–	–	–	63,603
	990,067	–	–	–	990,067
Total assets	$ 2,479,015	$ 34,366	$ 16,794	$ (12,626)	$ 2,517,549

Yale-New Haven Hospital, Inc. and Subsidiaries

Consolidating Balance Sheet (continued)

September 30, 2012
(In Thousands)

	Hospital	Lukan	Caritas	Eliminations	Total
Liabilities and net assets (deficiency)					
Current liabilities:					
Accounts payable	$ 133,902	$ 85	$ 64	$ –	$ 134,051
Accrued expenses	168,508	–	–	–	168,508
Professional liabilities –current portion	15,739	–	–	–	15,739
Current portion of debt	45,198	–	–	–	45,198
Current portion of capital lease obligation	55,292	–	–	–	55,292
Other current liabilities	2,847	–	79	–	2,926
Total current liabilities	421,486	85	143	–	421,714
Long-term debt, net of current portion	674,969	–	–	–	674,969
Long-term capital lease obligation, net of current portion	52,237	–	–	–	52,237
Accrued pension and postretirement benefit obligations	280,718	–	–	–	280,718
Professional liabilities	68,733	29,802	6,778		105,313
Other long-term liabilities	178,469	395	1,331	–	180,195
Deferred revenue	53,625	–	–	–	53,625
Total liabilities	1,730,237	30,282	8,252	–	1,768,771
Net assets:					
Unrestricted	676,008	4,084	8,542	(12,626)	676,008
Temporarily restricted	46,026	–	–	–	46,026
Permanently restricted	26,744	–	–	–	26,744
Total net assets	748,778	4,084	8,542	(12,626)	748,778
Total liabilities and net assets	$ 2,479,015	$ 34,366	$ 16,794	$ (12,626)	$ 2,517,549

Yale-New Haven Hospital, Inc. and Subsidiaries

Consolidating Statement of Operations and Changes in Net Assets

Year Ended September 30, 2012
(In Thousands)

	Hospital	Lukan	Caritas	Eliminations	Total
Operating revenue:					
Net patient service revenue	$ 1,713,271	$ –	$ –	$ –	$ 1,713,271
Other revenue	47,560	124	–	–	47,684
Total operating revenue	1,760,831	124	–	–	1,760,955
Operating expenses:					
Salaries and benefits	757,263	–	–	–	757,263
Supplies and other expenses	758,217	–	–	(159)	758,058
Depreciation	73,101	–	–	–	73,101
Insurance	15,328	215	137	–	15,680
Bad debts	32,622	–	–	–	32,622
Interest	17,720	–	–	–	17,720
Total operating expenses	1,654,251	215	137	(159)	1,654,444
Income (loss) from operations	106,580	(91)	(137)	159	106,511
Nonoperating gains (losses), net:	24,029	70	(1)	–	24,098
Excess (deficiency) of revenue over expenses	130,609	(21)	(138)	159	130,609

(Continued on next page.)

Yale-New Haven Hospital, Inc. and Subsidiaries

Consolidating Statement of Operations and Changes in Net Assets (continued)

Year Ended September 30, 2012
(In Thousands)

	Hospital	Lukan	Caritas	Eliminations	Total
Unrestricted net assets:					
Excess (deficiency) of revenue over expenses (continued)	$ 130,609	$ (21)	$ (138)	$ 159	$ 130,609
Other changes in net assets	342	–	–	–	342
Transfer to Yale-New Haven Health Services Corporation – Clinical Development Fund	(9,000)	–	–	–	(9,000)
Transfer from Yale-New Haven Health Services Corporation	2,900	–	–	–	2,900
Net Transfer from YNH Network Corporation	456	–	–	–	456
Net assets released from restrictions for purchases of fixed assets	258	–	–	–	258
Pension and other postretirement liability adjustments	(54,174)	–	–	–	(54,174)
Increase (decrease) in unrestricted net assets	71,391	(21)	(138)	159	71,391
Temporarily restricted net assets:					
Income from investments	280	–	–	–	280
Net realized gains on investments	471	–	–	–	471
Change in net unrealized gains and losses on investments	6,394	–	–	–	6,394
Bequests and contributions	11,847	–	–	–	11,847
Net assets released from restrictions for purchases of fixed assets	(258)	–	–	–	(258)
Net assets released from restrictions for free care	(889)	–	–	–	(889)
Net assets released from restrictions for operations	(2,962)	–	–	–	(2,962)
Net assets released from restrictions for clinical programs	(12,804)	–	–	–	(12,804)
Increase in temporarily restricted net assets	2,079	–	–	–	2,079
Permanently restricted net assets:					
Change in beneficial interest in perpetual trusts	1,221	–	–	–	1,221
Increase in permanently restricted net assets	1,221	–	–	–	1,221
Increase (decrease) in net assets	74,691	(21)	(138)	159	74,691
Net assets (deficiency) at beginning of year	674,087	4,105	8,680	(12,785)	674,087
Net assets (deficiency) at end of year	$ 748,778	$ 4,084	$ 8542	$ (12,626)	$ 748,778

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