

FINANCIAL STATEMENTS AND SUPPLEMENTARY  
INFORMATION

The William W. Backus Hospital  
Period From August 1, 2013 to September 30, 2013  
Period From October 1, 2012 to July 31, 2013, and  
Year Ended September 30, 2012  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

The William W. Backus Hospital

Financial Statements and Supplementary Information

Period From August 1, 2013 to September 30, 2013, Period From October 1, 2012 to July 31, 2013, and Year Ended September 30, 2012

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## Report of Independent Auditors

The Board of Directors  
Hartford Healthcare Corporation and Subsidiaries

We have audited the accompanying financial statements of The William W. Backus Hospital, which comprise the balance sheets as of September 30, 2013 and 2012, and the related statements of operations, changes in net assets and cash flows for the period from October 1, 2012 to July 31, 2013, the period from August 1, 2013 to September 30, 2013 and the year ended September 30, 2012, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The William W. Backus Hospital at September 30, 2013 and 2012, and the results of its operations, its changes in net assets and its cash flows for the period from October 1, 2012 to July 31, 2013, the period from August 1, 2013 to September 30, 2013, and the year ended September 30, 2012, in conformity with U.S. generally accepted accounting principles.

## **Supplementary Information**

Our audits were performed for the purpose of forming an opinion on the financial statements as a whole. The accompanying consolidating balance sheet and statement of operations are presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Ernst & Young LLP*

January 28, 2014

The William W. Backus Hospital

Balance Sheets

	September 30, 2013	Predecessor Company September 30, 2012
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 132,347,698	\$ 107,428,365
Assets whose use is limited – required for current liabilities	6,509,778	7,433,046
Accounts receivable, less allowance for uncollectible (2013 – \$16,761,000; 2012 – \$17,725,000, approximately)	31,013,657	32,015,340
Pledges receivable	29,416	31,723
Due from affiliates	184,696	562,041
Inventories of supplies	3,715,171	3,548,865
Prepaid expenses and other	3,009,572	3,330,298
Total current assets	<u>176,809,988</u>	154,349,678
Assets whose use is limited:		
Investments and other assets	112,198,811	102,230,331
Investments for restricted purposes	25,594,126	24,073,357
Investments for donor-restricted purposes	7,935,735	7,205,388
Funds designated for debt service	3,737,303	3,742,660
	<u>149,465,975</u>	137,251,736
Funds held in trust by others	2,515,481	2,359,047
Other assets	9,206,465	7,636,146
Property, plant, and equipment, net	138,743,906	91,354,486
Total assets	<u>\$ 476,741,815</u>	<u>\$ 392,951,093</u>

	September 30, 2013	Predecessor Company September 30, 2012
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 8,031,635	\$ 9,176,344
Salaries and wages, payroll taxes, and taxes withheld from payroll	6,965,186	6,802,151
Accrued liabilities	6,319,677	7,605,175
Current portion of pension and other postretirement	3,553,200	3,834,900
Estimated third-party payor settlements	1,828,257	1,193,235
Current portion of long-term debt	2,443,472	2,346,210
Total current liabilities	<u>29,141,427</u>	<u>30,958,015</u>
Long-term debt and capital leases	67,193,532	65,056,990
Accrued pension and other postretirement liabilities	18,267,625	66,410,217
Self-insured professional liability	14,348,700	9,685,357
Estimated third-party payor settlements	15,639,566	17,000,185
Other liabilities	6,659,958	5,978,216
Total liabilities	<u>151,250,808</u>	<u>195,088,980</u>
Net assets:		
Unrestricted	314,117,949	187,215,454
Temporarily restricted	3,305,592	2,890,743
Permanently restricted	8,067,466	7,755,916
Total net assets	<u>325,491,007</u>	<u>197,862,113</u>
Total liabilities and net assets	<u>\$ 476,741,815</u>	<u>\$ 392,951,093</u>

*See accompanying notes.*

The William W. Backus Hospital

Statements of Operations

	Period From August 1, 2013 to September 30, 2013	Predecessor Company	
		Period From October 1, 2012 to July 31, 2013	Year Ended September 30, 2012
Operating revenues:			
Net patient service revenue	\$ 46,288,627	\$ 230,444,135	\$ 283,219,755
Provision for uncollectible accounts	(1,489,352)	(7,234,583)	(7,949,694)
Net patient service revenue less provision for uncollectible accounts	44,799,275	223,209,552	275,270,061
Other operating revenues	710,072	6,723,682	7,774,319
Net assets released from restriction	28,253	217,331	174,552
	<b>45,537,600</b>	<b>230,150,565</b>	<b>283,218,932</b>
Operating expenses:			
Salaries and wages	19,188,089	98,064,757	114,140,337
Employee benefits	3,125,646	23,754,968	32,008,290
Supplies and other	8,606,513	38,839,806	45,487,984
Purchased services	7,633,095	32,300,609	43,735,241
Depreciation and amortization	2,684,973	12,838,658	18,006,195
Interest	557,418	2,817,755	3,276,169
	<b>41,795,734</b>	<b>208,616,553</b>	<b>256,654,216</b>
Operating income	<b>3,741,866</b>	<b>21,534,012</b>	<b>26,564,716</b>
Non-operating gains and (losses):			
Income from investments	1,287,032	8,971,598	12,701,591
Contributions	12,759	124,881	147,058
Other	1,600	(140,249)	(29,536)
Excess of revenues over expenses	<b>\$ 5,043,257</b>	<b>\$ 30,490,242</b>	<b>\$ 39,383,829</b>

See accompanying notes.

# The William W. Backus Hospital

## Statements of Changes in Net Assets

	Period From August 1, 2013 to September 30, 2013	Predecessor Company	
		Period From October 1, 2012 to July 31, 2013	Year Ended September 30, 2012
Beginning balance of unrestricted net assets:	\$ 308,205,973	\$ 187,215,454	\$ 153,345,431
Excess of revenue over expense	5,043,257	30,490,242	39,383,829
Change in pension and postretirement funding obligation	1,580,966	40,304,322	(4,361,697)
Transfer to affiliates	(712,247)	(2,082,312)	(1,248,123)
Net assets released from restriction used for the purchase of equipment	-	495,151	96,014
Ending balance of unrestricted net assets	<b>314,117,949</b>	<b>256,422,857</b>	187,215,454
Beginning balance of temporarily restricted net assets	3,099,995	2,890,743	1,399,547
Income from investments	141,818	485,326	1,315,791
Contributions	92,032	436,408	445,971
Net assets released from restriction	(28,253)	(712,482)	(270,566)
Ending balance of temporarily restricted net assets	<b>3,305,592</b>	<b>3,099,995</b>	2,890,743
Beginning balance of permanently restricted net assets	8,024,584	7,755,916	7,449,124
Appreciation of principle	-	155,116	-
Changes in net assets held in trust	42,882	113,552	306,792
Ending balance of permanently restricted net assets	<b>8,067,466</b>	<b>8,024,584</b>	7,755,916
Net assets at end of period	<b>\$ 325,491,007</b>	<b>\$ 267,547,436</b>	\$ 197,862,113

*See accompanying notes.*

# The William W. Backus Hospital

## Statements of Cash Flows

	Period From August 1, 2013 to September 30, 2013	Predecessor Company	
		Period From October 1, 2012 to July 31, 2013	Year Ended September 30, 2012
<b>Operating activities</b>			
Increase in net assets	\$ 6,160,455	\$ 69,685,323	\$ 35,668,011
Adjustments to reconcile increase in net assets to net cash provided by operating activities:			
Non-cash items:			
Depreciation and amortization	2,684,973	12,838,658	18,006,195
Provision for uncollectible accounts	1,489,352	7,234,583	7,949,694
Change in pension funding and postretirement obligation	(1,580,966)	(40,304,322)	4,361,697
Transfer to affiliates	712,247	2,082,312	1,248,123
Other changes in net assets:			
Purchase of investments – assets whose use is limited, net	(2,719,701)	(8,571,270)	(13,220,208)
Change in net assets held in trust	(42,882)	(268,668)	(306,792)
Changes in operating assets and liabilities <i>(Note 15)</i>	2,574,739	(16,644,276)	(22,740,929)
Net cash provided by operating activities	9,278,217	26,052,340	30,965,791
<b>Investing activities</b>			
Change in value of investments – held in trust by others, net	(42,882)	(113,551)	(306,792)
Net additions to property, plant, and equipment	(465,375)	(4,292,383)	(13,139,402)
(Increase) decrease in other assets	(648,658)	18,250	(76,231)
Net cash used in investing activities	(1,156,915)	(4,387,684)	(13,522,425)
<b>Financing activities</b>			
Principal payments on long-term debt and capital lease obligations	(50,249)	(2,295,959)	(2,165,194)
Change in deferred financing costs and amortization of bond premium	–	(37,408)	(44,693)
Change in net assets held in trust	42,882	268,668	306,792
Transfer to affiliates	(712,247)	(2,082,312)	(1,248,123)
Net cash used in financing activities	(719,614)	(4,147,011)	(3,151,218)
Net increase in cash and cash equivalents	7,401,688	17,517,645	14,292,148
Cash and cash equivalents at beginning of year	124,946,010	107,428,365	93,136,217
Cash and cash equivalents at end of year	\$ 132,347,698	\$ 124,946,010	\$ 107,428,365

See accompanying notes.

# The William W. Backus Hospital

## Notes to Financial Statements

September 30, 2013

### 1. Significant Accounting Policies

#### Organization

The William W. Backus Hospital (the Hospital), a voluntary association incorporated under the General Statutes of the State of Connecticut, is a wholly owned subsidiary of Backus Corporation (the sole member). Hartford Healthcare Corporation (HHC) elects a Board of Directors that has control of the operations of the Hospital. Refer to Note 8 for further discussion of related-party transactions.

The financial statements include the operations of Backus Medical Center Condominium Association, Inc. (the Association). All intercompany transactions have been eliminated in consolidation.

#### Affiliation

On August 1, 2013 (the Acquisition Date), HHC became the sole corporate member of Backus Corporation and a full corporate affiliation was completed. All assets and liabilities were revalued to fair value as of August 1, 2013. The Hospital is consolidated in HHC's financials for the period August 1, 2013 to September 30, 2013.

In connection with the acquisition, the assets and liabilities assumed were marked to fair value at the Acquisition Date. The increase in the Hospital's net assets at the Acquisition Date was \$51,783,116 when reported at fair value, as compared to the historical value of net assets as reported by the predecessor company. The \$51,783,116 increase in the Hospital's net assets was comprised of the following:

	<b>Increase (Decrease)</b>
Property, plant, and equipment	\$ 58,082,038
Long-term debt	(5,247,289)
Premium on bonds	629,869
Unamortized bond issue costs	(1,681,502)
	<u>\$ 51,783,116</u>

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

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

The accompanying financial statements present the financial position and results of operations for the period prior to the Acquisition Date, which are reported as the predecessor company at historical value, and subsequent to acquisition, which are reported using fair values as the cost basis established on the Acquisition Date.

The accompanying statements of operations, changes in net assets and cash flows disclose activity related to the periods from August 1, 2013 to September 30, 2013, October 1, 2012 to July 31, 2013, and the year ended September 30, 2012, and are hereafter referred to collectively as the “Periods under Audit.”

#### **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### **Regulatory Matters**

The Hospital is required to file annual operating information with the State of Connecticut Department of Public Health, Office of Health Care Access (OHCA).

#### **Fair Value of Financial Instruments**

The carrying value of financial instruments classified as current assets and current liabilities approximate fair value. The fair values of the Hospital’s financial instruments are disclosed in Note 5.

#### **Cash Equivalents**

The Hospital considers all highly liquid time deposits, commercial paper, and money market mutual funds purchased with a maturity at date of acquisition of three months or less to be cash equivalents. Cash and cash equivalents are maintained with domestic financial institutions with deposits that at times, exceed federally insured limits. It is the Hospital’s policy to monitor the financial strength of those institutions.

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

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

#### **Accounts Receivable and Net Patient Service Revenue**

Accounts receivable result from health care services provided by the Hospital. Additions to the allowance for uncollectible accounts result from provision of uncollectible accounts. Accounts written off as uncollectible are deducted from the allowance for uncollectible accounts. The amount of the allowance for uncollectible accounts is based on 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.

The Hospital's primary concentration of credit risk is patient accounts receivables that consist of amounts owed by various governmental agencies, insurance companies, and private patients. The Hospital manages the receivables by regularly reviewing its patient accounts and contracts and by providing appropriate allowances for uncollectible accounts. Concentrations of credit risk are disclosed in Note 11.

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

#### **Investments**

Marketable securities are classified as trading securities. Investments in debt and equity securities with readily determinable fair values are reported at fair value based on quoted market prices. Investment income or loss (including realized gains and losses on investments, interest, and dividends) and the change in the net unrealized gains and losses are included in the excess of revenues over expenses unless the income or loss is restricted by the donor.

#### **Inventories of Supplies**

Inventories of supplies are stated at the lower of cost (first-in, first-out method), or market.

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

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

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

Property, plant, and equipment are stated on the basis of cost. The Hospital provides for depreciation using the straight-line method in amounts sufficient to depreciate the cost of its assets over their estimated useful lives. Amortization of assets recorded under capital leases is included in depreciation expense.

#### **Assets Whose Use is Limited**

The Board of Trustees has designated certain unrestricted funds, including principal and income, for construction and other purposes. The President and Chief Executive Officer of the Hospital may, after consultation with the Chairman, Vice Chairman, or the Board of Trustees, use board-designated funds, if required, to meet short-term operating cash requirements of the Hospital. Assets whose use is limited also include assets required through a financing arrangement with the State of Connecticut Health and Educational Facilities Authority (the Authority), as more fully explained in Note 7. The portion of those amounts required for funding current liabilities is included in current assets. The carrying amounts reported in the accompanying balance sheets are stated at fair value.

#### **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 frame or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity.

#### **Donor-Restricted Gifts**

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

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

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

#### **Non-Operating Gains and Losses**

Activities other than those in connection with providing health care services are considered to be non-operating. Non-operating gains and losses primarily consist of income on invested funds.

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

The accompanying statements of operations and changes in net assets include the excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from the performance indicator, include equity transfers to/from affiliates, the change in pension and postretirement funding obligations, fair value adjustments, and net assets released from restriction used for the purchase of equipment.

#### **General and Professional Liability Self-Insurance**

The Hospital has adopted the policy of self-insuring the deductible portion of its general and professional liability insurance coverage. The deductible limits are \$1,000,000 per claim and \$5,000,000 annually for 2013 and 2012. Management accrues its best estimate of ultimate losses for both reported claims and claims incurred but not reported. The Hospital maintains a revocable trust for purposes of funding malpractice or comprehensive general liability losses.

#### **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 Association is a taxable entity; however, any taxes are immaterial to the financial statements of the Hospital taken as a whole.

#### **Electronic Health Record (EHR) Program**

The Centers for Medicare & Medicaid Services (CMS) have implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments for the meaningful use of certified EHR technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. Certain health care providers can earn incentive payments between 2011 and 2016 from Medicare and Medicaid

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

### 1. Significant Accounting Policies (continued)

for establishing an EHR system and maintaining its meaningful use. The Hospital recognizes income when it is reasonably assured that it is in compliance with the program criteria. During the Periods under Audit, the Hospital has included \$96,957, \$2,514,768, and \$2,777,416, respectively, in other operating revenue related to the program, including \$0, \$442,296, and \$737,160 received from Medicaid. The estimate for the Medicare program is based on cost report data that is subject to audit, and the amounts recognized are subject to change. The Hospital's attestation of compliance with the meaningful use criteria is subject to audit by the federal or state government or its designee.

### Reclassifications

Certain reclassifications have been made to the year ended September 30, 2012, balances previously reported in the accompanying balance sheets, statements of operations and changes in net assets in order to conform with the year ended September 30, 2013, presentation. Also, certain immaterial reclassifications to amounts and other presentation and disclosure changes were made to conform to HHC's financial reporting and disclosure policies.

### 2. Revenues From Services to Patients

The following table summarizes net revenues from services to patients:

	<b>Period From August 1, 2013 to September 30, 2013</b>	<b>Period From October 1, 2012 to July 31, 2013</b>	<b>Year Ended September 30, 2012</b>
Gross patient service revenue	\$ 110,196,629	\$ 540,230,711	\$ 615,524,464
Deductions:			
Allowances and discounts	(62,906,364)	(304,997,146)	(326,751,789)
Charity care (at charges)	(1,001,638)	(4,789,430)	(5,552,920)
Net patient service revenue	46,288,627	230,444,135	283,219,755
Provision for uncollectible accounts	(1,489,352)	(7,234,583)	(7,949,694)
Net patient service revenue less for uncollectible accounts	<u>\$ 44,799,275</u>	<u>\$ 223,209,552</u>	<u>\$ 275,270,061</u>

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

### **2. Revenues From Services to Patients (continued)**

Patient accounts receivable are recorded when patient services are performed. Differences between amounts received from most third-party payors and the established billing rates of the Hospital are accounted for as allowances.

Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, the Hospital considers historical trends and any known future environmental factors to estimate the appropriate allowance for uncollectible accounts and provision for uncollectible accounts. Management regularly reviews data about major payor sources of revenue in evaluating the sufficiency of the allowance. For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and records an allowance if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to have financial difficulties that make collection of amounts due unlikely). For receivables associated with self-pay patients (including both patients without insurance and patients with deductible and copayments due for which third-party coverage exists for part of the bill), the Hospital records a significant provision for uncollectible accounts in the period of service on the basis of its past experience, which indicates a high level of non-payment. The difference between either standard rates or negotiated discount rates and the amounts actually collected after reasonable collection efforts have been exhausted, is charged off against the allowance for uncollectible accounts.

The Hospital's allowance for uncollectible accounts decreased by approximately \$3,475,000 in 2012 due to improved collections, as well as a new policy whereby uninsured patients receive a discount equal to the average of the three lowest negotiated rates. Under the new policy, the discounted amount would no longer be included in allowance for uncollectible accounts (since self-pay accounts are significantly reserved for) and instead is included in the contractual allowance.

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### 2. Revenues From Services to Patients (continued)

The Hospital recognizes net patient service revenue for patients with third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on a discounted basis as described on the Hospital's patient business services policy. Patient service revenue for the Periods under Audit, net of contractual allowances and discounts, but before the provision for uncollectible accounts, recognized in the period is as follows:

	<b>Period From August 1, 2013 to September 30, 2013</b>	<b>Period From October 1, 2012 to July 31, 2013</b>	<b>Year Ended September 30, 2012</b>
Third-party payors	\$ 44,113,062	\$ 223,092,967	\$ 272,485,726
Self-pay	2,175,565	7,351,168	10,734,029
Total all payors	<u>\$ 46,288,627</u>	<u>\$ 230,444,135</u>	<u>\$ 283,219,755</u>

During the Periods under Audit, the Hospital recorded approximately \$0, \$494,000, and \$9,060,000, respectively, of previously recognized estimated third-party payor settlements resulting in an increase in net patient service revenue.

Revenues from the Medicare and Medicaid programs accounted for approximately 31.3% and 11.6%, respectively, of the Hospital's net patient service revenue for the period ended July 31, 2013; 32.3% and 11.5%, respectively, for the period ended September 30, 2013, and 32.1% and 9.4%, respectively, for the year ended September 30, 2012. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations, except as noted in Note 12. While no regulatory inquiries are outstanding, 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.

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### 3. Charity Care and Community Benefit

It is the policy of the Hospital that medically necessary health care services should be available to all individuals regardless of their ability to pay. The Hospital provides free or discounted care based on the criteria of its charity care policy. The policy utilizes the generally recognized poverty income levels for the state to determine the level of financial assistance. For patients who do not apply or do not qualify, the uncollected amounts are recognized as bad debt expense. Because the Hospital does not pursue collection of amounts determined to be charity care, such services are not reported as net revenue.

Together, charity care and provision for uncollectible accounts represent uncompensated care. The following table summarizes uncompensated care:

	<b>At Charge</b>	<b>Estimated</b>
Charity care	\$ 1,001,638	\$ 420,688
Provision for uncollectible accounts	1,489,352	625,528
Total uncompensated care, period from August 1, 2013 to September 30, 2013	<b>\$ 2,490,990</b>	<b>\$ 1,046,216</b>
Charity care	\$ 4,789,430	\$ 2,011,561
Provision for uncollectible accounts	7,234,583	3,038,525
Total uncompensated care, Period from October 1, 2013 to July 31, 2013	<b>\$ 12,024,013</b>	<b>\$ 5,050,086</b>
Charity care	\$ 5,552,920	\$ 2,276,697
Provision for uncollectible accounts	7,949,694	3,259,375
Total uncompensated care, September 30, 2012	<b>\$ 13,502,614</b>	<b>\$ 5,536,072</b>

Estimated cost is based on the ratio of cost to charges, as determined by Hospital-specific data.

In addition to charity care provided to patients, the Hospital supports programs that improve the health and well-being of the community. In 2013, the Hospital partnered with multiple community agencies in the Village of Baltic to provide weekly health outreach. The Village of Baltic was identified for this intensive outreach program by utilizing the Connecticut Hospital

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

### 3. Charity Care and Community Benefit (continued)

Association's ChimeMaps tool, giving the Hospital the ability to employ "hot spotting" techniques to determine pockets of need. The program provided primary care, health screenings, and education at no charge to participants, and was held every Friday at the Baltic Food Pantry. The Hospital also owns and operates two mobile health vans, which travel to various locations throughout Eastern Connecticut. The vans enable hospital and community providers to offer health education, counseling, and screening services, bringing preventative care directly to residents of Eastern Connecticut.

### 4. Investments

Investment income and gains are comprised of the following:

	<b>Period From August 1, 2013 to September 30, 2013</b>	<b>Period From October 1, 2012 to July 31, 2013</b>	<b>Year Ended September 30, 2012</b>
Unrealized gains on investments	\$ 352,480	\$ 4,760,681	\$ 10,067,106
Realized gains on investments	510,039	2,382,412	823,335
Interest and dividend income	444,930	2,189,279	2,164,471
Other investment income	2,000	10,000	12,000
Investment fees	(22,417)	(370,774)	(365,321)
	<u>\$ 1,287,032</u>	<u>\$ 8,971,598</u>	<u>\$ 12,701,591</u>

The William W. Backus Hospital

Notes to Financial Statements (continued)

**4. Investments (continued)**

The market value of assets whose use is limited at September 30 is set forth in the following table:

	<u>2013</u>	<u>2012</u>
Assets whose use is limited:		
Cash and cash equivalents	\$ 1,745,332	\$ 3,290,376
Certificates of deposit	24,945,386	24,925,922
Money market funds	18,694,650	16,492,371
Equity securities:		
U.S.	26,508,212	22,039,195
International	427,435	405,946
Fixed income bonds		
U.S.	20,832,689	20,887,250
International	603,377	605,848
Mutual funds		
U.S.	46,826,584	46,535,019
International	12,064,138	8,387,171
Alternate investments and other	3,327,950	1,115,684
	<u>\$ 155,975,753</u>	<u>\$ 144,684,782</u>

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) provides guidance on investment decisions and endowment expenditures for nonprofit organizations. The Board of Trustees of the Hospital has interpreted UPMIFA as requiring the preservation of the fair value of the original gift at the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, the Hospital classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment, (b) the original value of the subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time 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.

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

### **4. Investments (continued)**

The primary objective of the endowment fund is to provide long-term support for the Hospital's capital and operating programs. The Hospital's investment goals are to maximize total return (capital appreciation, dividends, and interest) while also protecting the Hospital's inflation-adjusted value over time. The Hospital's assets are diversified across multiple asset classes (e.g., common stocks, bonds, and cash) to achieve an optimal balance between risk and return and between current income and capital appreciation. The investment program is structured to offer reasonably high probability of generating a real return of 5% per year over a period of five to ten years to protect the real inflation-adjusted value of assets and to meet the spending requirements. The Investment Committee reviews investment policies annually to determine if changes need to be made due to changing market conditions or other factors.

Management evaluates endowment spending in light of capital replacement and expansion plans. The spending policy does not apply a prescribed rate of spending in a given year, but does consider the following factors in making determinations to appropriate or accumulate donor restricted endowment funds:

- (1) The duration and preservation of the fund.
- (2) The purposes of 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.
- (7) The investment policies of the Hospital.

Endowment assets are donor-restricted gifts that are meant to provide a permanent source of income to the Hospital and are included in permanently restricted net assets. Any deficits are funded with available temporarily restricted or unrestricted funds so as to maintain the corpus. Subsequent positive market returns replace the deficits.

The William W. Backus Hospital

Notes to Financial Statements (continued)

**4. Investments (continued)**

The activity for the year ended September 30, 2013, is as follows:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets at beginning of year	\$ 1,116,993	\$ 5,396,869	\$ 6,513,862
Investment return:			
Investment income	–	263,499	263,499
Net appreciation (realized and unrealized)	–	323,437	323,437
Earnings reclassified	431,820	(431,820)	–
Total investment return	<u>431,820</u>	<u>155,116</u>	<u>586,936</u>
Endowment net assets at end of year	<u>\$ 1,548,813</u>	<u>\$ 5,551,985</u>	<u>\$ 7,100,798</u>

The activity for the year ended September 30, 2012, is as follows:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets at beginning of year	\$ 417,004	\$ 5,396,869	\$ 5,813,873
Investment return:			
Investment income	–	99,346	99,346
Net appreciation (realized and unrealized)	–	600,643	600,643
Earnings reclassified	699,989	(699,989)	–
Total investment return	<u>699,989</u>	<u>–</u>	<u>699,989</u>
Endowment net assets at end of year	<u>\$ 1,116,993</u>	<u>\$ 5,396,869</u>	<u>\$ 6,513,862</u>

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### **5. Fair Values of Financial Instruments**

For assets and liabilities required to be measured at fair value, the Hospital measures fair value based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are applied based on the unit of account from the Hospital's perspective. The unit of account determines what is being measured by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting pronouncements.

The Hospital follows a valuation hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad categories. Level one inputs are quoted market prices in active markets that are accessible at the measurement date. Level two inputs are observable, but not quoted in active markets. Level three inputs are unobservable and are used when little or no market data is available.

Fair value for Level 2 assets are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources, including market participants, dealers, and brokers. Level 3 assets consist of asset-backed and mortgage-backed obligations held by the defined benefit plan, which are priced using model-based valuations using market information that best represents the value at which the security could be sold.

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

Although no transfers between levels have occurred in this fiscal year, the Hospital's policy is to recognize the transfer at the end of the reporting period.

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### 5. Fair Values of Financial Instruments (continued)

Financial assets and liabilities as of September 30, 2013, are classified in the table below:

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 134,093,030	\$ –	\$ –	\$ 134,093,030
Certificates of deposit	–	24,945,386	–	24,945,386
Money market funds	18,694,650	–	–	18,694,650
Equity securities:				
U.S. <sup>(a)</sup>	26,508,212	–	–	26,508,212
International <sup>(b)</sup>	427,435	–	–	427,435
Fixed income bonds: <sup>(c)</sup>				
U.S.	–	20,832,689	–	20,832,689
International	–	603,377	–	603,377
Mutual funds:				
U.S. <sup>(d)</sup>	12,988,025	33,838,559	–	46,826,584
International <sup>(e)</sup>	11,569,985	494,153	–	12,064,138
Alternative investments and other <sup>(f)</sup>	–	3,327,950	–	3,327,950
Funds held in trust by others	–	2,515,481	–	2,515,481
<b>Total</b>	<b>\$ 204,281,337</b>	<b>\$ 86,557,595</b>	<b>\$ –</b>	<b>\$ 290,838,932</b>
<b>Liabilities</b>				
Fixed rate debt	\$ –	\$ 63,533,406	\$ –	\$ 63,533,406

<sup>(a)</sup> This class seeks capital appreciation by investing in stocks of large U.S. companies.

<sup>(b)</sup> This class seeks capital appreciation by investing in stocks of large non-U.S. companies.

<sup>(c)</sup> This class seeks maximum current income primarily through investments in fixed income securities of varying maturities.

<sup>(d)</sup> This class seeks maximum real return by investing in stocks of large U.S. companies.

<sup>(e)</sup> This class seeks long-term capital appreciation by investing in large non-U.S. companies whose shares have a high book value in relation to their market value.

<sup>(f)</sup> This class targets total returns over the long term as measured by the Consumer Price Index + 5%, investing in index funds and various stock.

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### 5. Fair Values of Financial Instruments (continued)

Financial assets as of September 30, 2012, are classified in the table below:

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 110,308,441	\$ 410,300	\$ –	\$ 110,718,741
Certificates of deposit	–	24,925,922	–	24,925,922
Money market funds	16,492,371	–	–	16,492,371
Equity securities:				
U.S. <sup>(a)</sup>	22,039,195	–	–	22,039,195
International <sup>(b)</sup>	405,946	–	–	405,946
Fixed income bonds: <sup>(c)</sup>				
U.S.	–	20,887,250	–	20,887,250
International	–	605,848	–	605,848
Mutual funds:				
U.S. <sup>(d)</sup>	11,511,414	35,023,605	–	46,535,019
International <sup>(e)</sup>	7,850,395	536,776	–	8,387,171
Alternative investments and other <sup>(f)</sup>	–	1,115,684	–	1,115,684
Funds held in trust by others	–	2,359,047	–	2,359,047
<b>Total</b>	<b>\$ 168,607,762</b>	<b>\$ 85,864,432</b>	<b>\$ –</b>	<b>\$ 254,472,194</b>
<b>Liabilities</b>				
Fixed rate debt	\$ –	\$ 72,441,444	\$ –	\$ 72,441,444

(a) This class seeks capital appreciation by investing in stocks of large U.S. companies.

(b) This class seeks capital appreciation by investing in stocks of large non-U.S. companies.

(c) This class seeks maximum current income primarily through investments in fixed income securities of varying maturities.

(d) This class seeks maximum real return by investing in stocks of large U.S. companies.

(e) This class seeks long-term capital appreciation by investing in large non-U.S. companies whose shares have a high book value in relation to their market value.

(f) This class targets total returns over the long term as measured by the Consumer Price Index + 5%, investing in index funds and various stock.

The William W. Backus Hospital

Notes to Financial Statements (continued)

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

The following table presents the Hospital's fair value hierarchy for defined benefit plan assets as of September 30, 2013.

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Money market funds	\$ 2,758,810	\$ —	\$ —	\$ 2,758,810
Fixed income bonds: <sup>(a)</sup>				
U.S.	—	27,205,353	—	27,205,353
International	—	3,586,219	—	3,586,219
Mutual funds:				
U.S. <sup>(b)</sup>	30,752,217	70,077,144	—	100,829,361
International <sup>(c)</sup>	23,296,667	—	—	23,296,667
<b>Total</b>	<b>\$ 56,807,694</b>	<b>\$ 100,868,716</b>	<b>\$ —</b>	<b>\$ 157,676,410</b>

<sup>(a)</sup> This class seeks maximum current income primarily through investments in fixed income securities of varying maturities.

<sup>(b)</sup> This class primarily represents investments in common stocks or similar securities of high-quality, financially secure companies listed on principal exchanges.

<sup>(c)</sup> This class seeks long-term growth of capital with at least 80% of its investments in international equity securities.

The following table presents reconciliation for all Level 3 assets measured at fair value for the period October 1, 2012 to September 30, 2013.

	<b>Mortgage- Backed Obligations</b>
Beginning balance	\$ 188,330
Unrealized gains	5,270
Sales	(193,600)
<b>Total</b>	<b>\$ —</b>

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### 5. Fair Values of Financial Instruments (continued)

The following table presents the Hospital's fair value hierarchy for defined benefit plan assets as of September 30, 2012. At September 30, 2012, Level 3 assets comprise approximately 0.1% of the Hospital Plan's total investment portfolio fair value.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets</b>				
Money market funds	\$ 9,832,723	\$ —	\$ —	\$ 9,832,723
Fixed income bonds: <sup>(a)</sup>				
U.S.	—	27,084,665	188,330	27,272,995
International	—	2,815,389	—	2,815,389
Mutual funds:				
U.S. <sup>(b)</sup>	25,164,036	55,420,564	—	80,584,600
International <sup>(c)</sup>	19,186,295	—	—	19,186,295
<b>Total</b>	<u>\$ 54,183,054</u>	<u>\$ 85,320,618</u>	<u>\$ 188,330</u>	<u>\$ 139,692,002</u>

<sup>(a)</sup> This category seeks maximum current income primarily through investments in fixed income securities of varying maturities.

<sup>(b)</sup> This category primarily represents investments in common stocks or similar securities of high-quality, financially secure companies listed on principal exchanges.

<sup>(c)</sup> This category seeks long term growth of capital with at least 80% of its investments in international equity securities.

The following table presents reconciliation for all Level 3 assets measured at fair value for the period October 1, 2011 to September 30, 2012.

	<u>Mortgage- Backed Obligations</u>
Beginning balance	\$ 180,660
Unrealized gains	7,670
<b>Total</b>	<u>\$ 188,330</u>

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### 5. Fair Values of Financial Instruments (continued)

The carrying amount of certain of the Hospital's financial instruments, including cash and cash equivalents approximates fair value due to the relatively short maturities of such instruments. Fair values of investments are based on quoted market prices and are recorded on the balance sheets as such.

#### 6. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets at September 30 are available for the following purposes:

	2013	2012
General use	\$ 1,621,905	\$ 1,186,206
Health care services	889,639	1,055,363
Preventative care	214,764	227,207
Extraordinary nursing care	180,939	131,654
Nursing education	150,759	108,153
Free beds	128,382	103,979
Laboratory	119,204	78,181
	\$ 3,305,592	\$ 2,890,743

Permanently restricted net assets at September 30 are restricted for:

	2013	2012
Investments to be held in perpetuity, the income from which is expendable to support health care service	\$ 5,551,985	\$ 5,396,869
Restricted funds held in trust by others, the income from which is expendable to support health care services	2,515,481	2,359,047
	\$ 8,067,466	\$ 7,755,916

The William W. Backus Hospital  
Notes to Financial Statements (continued)

**7. Long-Term Debt**

A summary of long-term debt at September 30 is as follows:

	<u>2013</u>	<u>2012</u>
Tax-exempt Hospital Revenue Bonds:		
Series E, term maturities (\$6,920,000) from 2017 to 2022 at an interest rate of 5.00%	\$ 7,647,301	\$ 7,515,000
Series F, serial maturities (\$4,350,000) from 2014 to 2018, with interest rates of 4.00% to 4.25%, term maturities (\$22,125,000) from 2023 to 2035 with interest rates of 5.00% to 5.25%	28,945,938	27,250,000
Series G, serial maturities (\$16,405,000) from 2014 to 2026, with interest rates of 3.60% to 5.00%, term maturities (\$7,420,000) in 2035 at an interest rate of 5%	25,412,237	24,500,000
Other long-term debt:		
Mortgage, maturing May 1, 2025, with a fixed interest rate of 6.125%	1,527,930	1,126,557
Obligations under capital leases	6,103,598	6,344,367
	<u>69,637,004</u>	<u>66,735,924</u>
Add net unamortized bond premium	—	667,276
Less current portion	(2,443,472)	(2,346,210)
Long-term debt	<u>\$ 67,193,532</u>	<u>\$ 65,056,990</u>

The Master Indenture, as amended and supplemented by Supplemental Master Indenture No. 4, provides for, among other things, a pledge of the gross receipts, as defined, of the Hospital, restriction on the incurrence of certain indebtedness of the Hospital, and covenants regarding the Hospital's debt service coverage ratios, sale and lease of assets, and other covenants similar in financings of this type. The bonds are secured by the real property of the Hospital, including all buildings and equipment. Pursuant to the loan agreements, the Hospital is obligated to provide amounts that will be sufficient to enable the Authority to pay the principal and interest on the Series E, Series F, and Series G bonds.

The William W. Backus Hospital

Notes to Financial Statements (continued)

**7. Long-Term Debt (continued)**

Series E bonds are subject to optional redemption prior to maturity. Series F bonds are subject to optional redemption prior to maturity. Series G bonds maturing after July 1, 2015, are subject to optional redemption prior to maturity.

Future minimum payments on long-term debt and future minimum payments and interest on capital leases during each of the next five fiscal years, and in the aggregate, are as follows:

	<b>Long-Term Debt</b>	<b>Capital Leases</b>
2014	\$ 2,184,302	\$ 802,524
2015	2,303,411	778,179
2016	2,387,624	705,224
2017	2,482,423	705,224
2018	2,582,371	705,224
Aggregate thereafter	51,593,275	7,595,815
	<u>63,533,406</u>	<u>11,292,190</u>
Less interest	-	(5,188,592)
	<u>\$ 63,533,406</u>	<u>\$ 6,103,598</u>

The Hospital paid interest of \$95,899, \$3,339,278, and \$3,340,832 for the Periods under Audit, respectively. Interest incurred for the Period under Audit was \$557,418, \$2,817,755, and \$3,276,169, respectively.

In 2012, the Hospital entered into a 20-year capital lease of \$5,108,015 with an interest rate of 6.06% for a building located at 582 Norwich Road, Plainfield, CT, to be used for emergency, radiology, and lab services. Under the terms of the lease, the Hospital has the option for two additional five-year terms, as well as an option to purchase the property. The outstanding balance on this capital lease at September 30, 2013, was \$4,919,654.

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### **7. Long-Term Debt (continued)**

In 2010, the Hospital entered into a five-year capital lease of \$458,781 with an interest rate of 5.9% for a building located at 80 Route 32, Montville, CT, to be used for patient services. The outstanding balance on this capital lease at September 30, 2013, was \$161,377.

In 2010, the Hospital entered into a fixed rate commercial mortgage of \$1,250,000 for a period of 15 years at a rate of 6.125%. The note is secured by real property located at 11 Stott Avenue, Norwich, CT.

In 2004, the Hospital entered into a 20-year capital lease of \$1,094,640 with an interest rate of 4.875% for a building located at 151-163 Broadway, Colchester, CT, to be used for patient services. The outstanding balance on this capital lease at September 30, 2013, is \$1,022,567.

#### **8. Related-Party Transactions**

The Hospital processes payroll and disbursements for several of its affiliated entities for which it is reimbursed. Reimbursements due to the Hospital at September 30, 2013 and 2012, were approximately \$185,000 and \$562,000, respectively. The Hospital also leases space to its affiliated entities. Rental income from the affiliates for the Periods under Audit is \$81,597, \$410,331, and \$411,697, respectively.

#### **9. Retirement Benefit Plans**

Effective January 1, 2010, the Hospital amended its defined benefit pension plan to close the plan to new participants and to freeze accruals for the existing participants in favor of a defined contribution plan.

The defined contribution plan covers substantially all of the employees of the Hospital. Under the provisions of the plan, the Hospital will make non-elective contributions to the plan on behalf of each eligible employee in the amount of 3% of the employee's eligible earnings. The Hospital will also make a non-elective transition contribution equal to 3% of employee's eligible earnings for all employees who meet the transition participant criteria. The Hospital may also, at the discretion of the Board of Trustees, make an elective matching contribution at the end of the plan year based on the Hospital's financial performance. The cost recorded for the Periods under Audit are \$611,400, \$4,361,092, and \$4,675,303, respectively.

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### 9. Retirement Benefit Plans (continued)

The Hospital also provides non-contributory postretirement health care benefits to eligible retirees and to eligible spouses of retirees who retired prior to January 1, 1994. Subsequent to 1993, covered retirees contribute a percentage of the cost based on years of service. In addition, the Hospital sponsors a nonqualified pension benefit program. Included in other long-term liabilities at September 30, 2013 and 2012, are approximately \$1,204,000 and \$1,455,000, respectively, related to the future obligation for the nonqualified benefits.

Included in unrestricted net assets at September 30 are the following amounts that have not yet been recognized in net periodic benefit cost:

	Pension Benefits			Postretirement Benefits		
	Period From August 1, 2013 to September 30, 2013	Period From October 1, 2012 to July 31, 2013	Year Ended September 30, 2012	Period From August 1, 2013 to September 30, 2013	Period From October 1, 2012 to July 31, 2013	Year Ended September 30, 2012
	<i>(In Thousands)</i>					
Unrecognized actuarial (loss) gain	\$ 1,582	\$ -	\$ (69,083)	\$ (1)	\$ -	\$ 1,476
Unrecognized transition obligation	-	-	-	-	-	(242)
	\$ 1,582	\$ -	\$ (69,083)	\$ (1)	\$ -	\$ 1,234

There is no actuarial loss or transition obligation included in unrestricted net assets that is expected to be recognized in net periodic benefit cost during 2014.

At September 30, 2013, the unfunded status of the pension plan is included in long-term liabilities in the amount of \$14,032,589. The unfunded status of the postretirement benefits is \$3,408,366, with \$377,682 included in short-term liabilities, and the remainder of \$3,030,684 included in long-term liabilities. At September 30, 2012, the unfunded status of the pension plan is included in long-term liabilities in the amount of \$61,486,044. The unfunded status of the postretirement benefits \$3,882,076, with \$412,955 included in short-term liabilities, and the remainder of \$3,469,121 included in long-term liabilities.

The William W. Backus Hospital

Notes to Financial Statements (continued)

**9. Retirement Benefit Plans (continued)**

The following tables set forth the funded status of the plans as of September 30:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<i>(In Thousands)</i>			
<b>Change in projected benefit obligation</b>				
Benefit obligation at beginning of year	\$ (201,178)	\$ (175,946)	\$ (3,882)	\$ (4,083)
Service cost				(1)
Interest cost	(7,681)	(7,981)	(139)	(178)
Change in assumptions	31,468	(22,583)	54	(216)
Actuarial gain	161	118	178	184
Benefits paid	5,521	5,214	381	412
Benefit obligation at end of year	<u>\$ (171,709)</u>	<u>\$ (201,178)</u>	<u>\$ (3,408)</u>	<u>\$ (3,882)</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	\$ 139,692	\$ 115,644	\$ -	\$ -
Actual return on plan assets	15,405	21,162	-	-
Contributions	8,100	8,100	381	412
Benefits paid	(5,521)	(5,214)	(381)	(412)
Fair value of plan assets at end of year	<u>\$ 157,676</u>	<u>\$ 139,692</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Underfunded status</b>				
Accrued benefit liability recognized in the balance sheets	<u>\$ (14,033)</u>	<u>\$ (61,486)</u>	<u>\$ (3,408)</u>	<u>\$ (3,882)</u>

The William W. Backus Hospital

Notes to Financial Statements (continued)

**9. Retirement Benefit Plans (continued)**

	Pension Benefits			Postretirement Benefits		
	Period From August 1, 2013 to September 30, 2013	Period From October 1, 2012 to July 31, 2013	Year Ended September 30, 2012	Period From August 1, 2013 to September 30, 2013	Period From October 1, 2012 to July 31, 2013	Year Ended September 30, 2012
	<i>(In Thousands)</i>					
<b>Components of net periodic benefit cost</b>						
Service cost	\$ -	\$ -	\$ -	\$ -	\$ -	1
Interest cost	1,398	6,283	7,981	22	117	178
Expected return on plan assets	(2,178)	(13,228)	(7,908)	-	-	-
Net amortization and deferral	421	9,477	4,651	-	127	230
Net periodic benefit cost	\$ (359)	\$ 2,532	\$ 4,724	\$ 22	\$ 244	\$ 409

	Pension Benefits		Postretirement Benefits	
	2013	2012	2013	2012
<b>Assumptions:</b>				
Weighted-average assumptions used to determine benefit obligations:				
Discount rate	5.00%	3.80%	4.05%	3.80%
Weighted-average assumptions used to determine net periodic benefit cost:				
Discount rate	4.95%	4.60%	4.05%	4.60%
Expected long-term rate of return on plan assets	6.75%	6.75%		

The accumulated benefit obligation at September 30, 2013 and 2012, was \$171,708,999 and \$201,178,047, respectively.

The William W. Backus Hospital

Notes to Financial Statements (continued)

**9. Retirement Benefit Plans (continued)**

The asset allocations for the retirement plan at the end of 2013 and 2012 and the target allocation by asset category are as follows:

Asset Category	Target Allocation		Percentage of Plan Assets	
	Minimum	Maximum	2013	2012
US equity large cap	20%	50%	39%	37%
US equity small cap		15	5	5
International equity	10	30	15	14
Core fixed income	20	60	41	44
Total			100%	100%

The Hospital Plan's investment policy includes target asset allocations percentages as shown above. The investment objective for the Hospital Plan is to produce a total rate of return (net of fees) that meets or exceeds the actuarial return assumption used for funding purposes, while generally striving to minimize significant variations in annual contribution levels through investment diversification. Investment return assumptions are developed through a multi-step process using external economic research, including industry surveys and published economic research combined with internal economic scenario analysis, historical market returns, and correlation trends.

Information about the expected cash flows for both plans is as follows:

	Pension Benefits	Postretirement Benefits
Expected employer contributions for 2014	\$ —	\$ 377,682
Estimated future benefit payments:		
2014	6,651,060	377,682
2015	7,202,318	358,286
2016	7,672,972	339,041
2017	8,196,577	319,767
2018	8,865,390	300,717
2019-2023	52,576,616	1,229,691

The William W. Backus Hospital

Notes to Financial Statements (continued)

**9. Retirement Benefit Plans (continued)**

The assumed health care cost trend rate used to measure the expected cost of benefits covered by the postretirement health benefit plan for the next year is no longer applicable. Effective this year, the annual premium has exceeded the cap and therefore, the Hospital's cost will not increase in the future with the medical trend.

A one-percentage-point change in assumed health care cost trend rates would have the following effects on the postretirement benefit plan:

	<b>One-Percentage-Point</b>	
	<b>Increase</b>	<b>Decrease</b>
Effect on total of service and interest cost components	\$ 97	\$ (83)
Effect on postretirement benefit obligation	\$ —	\$ —

**10. Property, Plant, and Equipment**

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

	<b>2013</b>	<b>2012</b>
Land and land improvements	\$ 8,395,039	\$ 4,862,121
Buildings and leasehold improvements	183,404,866	129,515,253
Equipment	107,805,047	104,187,422
Construction-in-process (2013 estimated cost to complete \$3,820,000)	77,152	1,747,654
	<b>299,682,104</b>	<b>240,312,450</b>
Less accumulated depreciation	<b>(160,938,198)</b>	<b>(148,957,964)</b>
	<b>\$ 138,743,906</b>	<b>\$ 91,354,486</b>

Amortization expense related to internally developed software for the years ended September 30, 2012, was \$388,314.

The Hospital wrote off approximately \$2,848,000 of fully depreciated assets in 2013.

## The William W. Backus Hospital

### Notes to Financial Statements (continued)

#### 10. Property, Plant, and Equipment (continued)

The Hospital leases space to be used for patient service. The original term of the lease expired September 30, 2013, and the Hospital opted to exercise the first of the two five-year options. Rent expense for the Period under Audit was \$96,856, \$706,707, and \$755,190, respectively.

The Hospital leases various types of equipment with annual payments ranging from \$14 to \$53,000. Expenses as a result of these leases were approximately \$37,000, \$129,000, and \$270,000 for the Period under Audit, respectively.

Future minimum lease payments under the above leases during each of the next five years were as follows:

2014	\$	843,694
2015		754,954
2016		644,089
2017		615,188
2018		604,483
Thereafter		—
		\$ 3,462,408

#### 11. Concentrations of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross accounts receivable from patients and third-party payors at September 30 is as follows:

	<b>2013</b>	<b>2012</b>
Medicare	<b>37%</b>	32%
Self-pay	<b>20</b>	21
Health Maintenance Organizations	<b>16</b>	15
Anthem Blue Cross/Blue Shield	<b>13</b>	15
Medicaid	<b>6</b>	8
Commercial	<b>5</b>	6
Other state agencies	<b>3</b>	3
	<b>100%</b>	100%

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

### **12. Contingencies**

There have been malpractice claims that fall within the Hospital's partially self-insured program (see Note 1) that have been asserted against the Hospital. In addition, there are known incidents that have occurred through September 30, 2013, that may result in the assertion of claims. Hospital management, in conjunction with its consulting actuaries, has accrued its best estimate of these contingent losses.

Hospital management believes that it may not have conformed to all applicable laws and regulations regarding certain arrangements with outside parties. An internal investigation is ongoing, and management has estimated and accrued a liability related to this matter. Except for this matter, Hospital management 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 any potential wrongdoing.

The Hospital is a party to various lawsuits incidental to its business. Management believes that the lawsuits will not have a material adverse effect on the Hospital's financial position or results of operations.

Hospital employees covered by collective bargaining agreements represent approximately 23% and 22% of total employees as of September 30 2013, and 2012, respectively. The SPFPA (Security, Police, and Fire Professionals of America) contract is due to expire in August of 2014 and represents approximately 2% of the total employees.

The William W. Backus Hospital

Notes to Financial Statements (continued)

**13. Other Operating Revenues**

Other operating revenues consist of the following:

	<b>Period From August 1, 2013 to September 30, 2013</b>	<b>Period From October 1, 2012 to July 31, 2013</b>	<b>Year Ended September 30, 2012</b>
Cafeteria sales	\$ 201,149	\$ 1,024,093	\$ 1,166,526
Rental income	162,794	716,306	1,025,861
EHR income	96,957	2,514,768	2,777,416
Condominium income	81,379	395,657	492,179
Child care	50,094	329,753	398,545
Miscellaneous	40,438	415,068	224,255
Fee income	39,936	394,471	454,529
Interest	15,777	149,621	249,145
Grants	15,000	571,588	614,920
Purchase discounts	6,548	212,357	370,943
	<u>\$ 710,072</u>	<u>\$ 6,723,682</u>	<u>\$ 7,774,319</u>

**14. Functional Expenses**

The Hospital provides inpatient medical and surgical, outpatient, psychiatric, and emergency care services to residents of eastern Connecticut. Expenses related to providing these services are as follows:

	<b>Period From August 1, 2013 to September 30, 2013</b>	<b>Period From October 1, 2012 to July 31, 2013</b>	<b>Year Ended September 30, 2012</b>
Health care services	\$ 32,266,325	\$ 162,235,409	\$ 199,189,567
General and administrative	9,507,835	46,214,438	57,263,709
Fund-raising	21,574	166,706	200,940
	<u>\$ 41,795,734</u>	<u>\$ 208,616,553</u>	<u>\$ 256,654,216</u>

The William W. Backus Hospital

Notes to Financial Statements (continued)

**14. Functional Expenses (continued)**

Costs for interest and insurance are included in general and administrative expenses. Professional liability insurance is included in health care services.

**15. Cash Flows**

Changes in operating assets and liabilities at September 30 include the following:

	<b>Period From August 1, 2013 to September 30, 2013</b>	<b>Period From October 1, 2012 to July 31, 2013</b>	<b>Year Ended September 30, 2012</b>
(Increase) decrease in assets:			
Accounts receivable	\$ (758,134)	\$ (6,964,118)	\$ (7,591,912)
Pledges receivable	1,895	412	69,488
Due from affiliates	(26,158)	403,503	(397,894)
Inventories of supplies, prepaid expenses, and other	705,973	(551,553)	(1,550,490)
Increase (decrease) in liabilities:			
Accounts payable	749,962	(1,894,671)	(742,115)
Salaries and wages, payroll taxes and taxes withheld from payroll	(373,268)	536,303	136,013
Accrued liabilities	916,324	(2,201,822)	1,870,890
Accrued pension and other post retirement liabilities	(1,297,510)	(5,241,494)	(6,558,518)
Self-insured professional liability	624,737	1,428,572	(4,539,196)
Estimated third party payor settlements	2,143,707	(2,869,304)	(5,652,284)
Other liabilities	(112,789)	709,896	2,215,089
	<u>\$ 2,574,739</u>	<u>\$ (16,644,276)</u>	<u>\$ (22,740,929)</u>

# The William W. Backus Hospital

## Notes to Financial Statements (continued)

### **16. Subsequent Events**

The Hospital evaluates the impact of subsequent events, which are events that occur after the balance sheet date but before the financial statements are issued, for potential recognition in the financial statements as of the balance sheet date for the year ended September 30, 2013. The Hospital evaluated subsequent events through January 28, 2014, which is the date the financial statements were issued.

Effective November 20, 2013, the Hospital entered into an agreement with Hartford HealthCare Endowment LLC (Endowment LLC), a wholly owned subsidiary of HHC, for the management of the Hospital's endowment assets. Endowment LLC acts as manager and is named fiduciary, for HHC within established investment guidelines. As of January 1, 2014, \$53,112,368 of the Hospital's investments were liquidated and transferred to Endowment LLC, at which time all previously unrealized gains and losses on the sold investments were realized. Subsequent to the transfer, the Hospital has an interest in investments held by Endowment LLC, which represents their pro rata share of Endowment LLC.

Effective January 1, 2014, the assets of the Hospital's pension plan were liquidated and \$163,446,172 of cash was transferred into the Hartford healthcare Defined Benefit Master Trust, at which time all previously unrealized gains and losses on the liquidated investments were realized.

Effective January 2014, the Board of Directors of the Hospital resolved to become a part of the HHC Obligated Group. The Obligated Group subsequently entered into a bridge loan in the amount of \$80,902,000, part of which will be used to defease the Hospital's outstanding CHEFA bonds. The bridge loan has an adjustable interest rate based on LIBOR, is due in monthly installments and matures in April 2014.

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

## Supplementary Information

# The William W. Backus Hospital

## Consolidating Balance Sheet

September 30, 2013

	<b>The William W. Backus Hospital</b>	<b>Backus Medical Center Condominium Association, Inc.</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 132,347,698	\$ —	\$ —	\$ 132,347,698
Assets whose use is limited – required for current liabilities	6,509,778	—	—	6,509,778
Accounts receivable, less allowance for uncollectible accounts	31,013,657	—	—	31,013,657
Pledges receivable	29,416	—	—	29,416
Due from affiliates	218,071	—	(33,375)	184,696
Inventories of supplies	3,715,171	—	—	3,715,171
Prepaid expenses and other	2,941,851	67,721	—	3,009,572
Total current assets	<u>176,775,642</u>	<u>67,721</u>	<u>(33,375)</u>	<u>176,809,988</u>
Assets whose use is limited:				
Investments and other assets	112,198,811	—	—	112,198,811
Investments for restricted purposes	25,594,126	—	—	25,594,126
Investments for donor restricted purposes	7,935,735	—	—	7,935,735
Funds designated for debt service	3,737,303	—	—	3,737,303
	<u>149,465,975</u>	<u>—</u>	<u>—</u>	<u>149,465,975</u>
Funds held in trust by others	2,515,481	—	—	2,515,481
Other assets	9,206,465	—	—	9,206,465
Property, plant, and equipment, net	138,743,906	—	—	138,743,906
Total assets	<u>\$ 476,707,469</u>	<u>\$ 67,721</u>	<u>\$ (33,375)</u>	<u>\$ 476,741,815</u>

# The William W. Backus Hospital

## Consolidating Balance Sheet (continued)

September 30, 2013

	<b>The William W. Backus Hospital</b>	<b>Backus Medical Center Condominium Association, Inc.</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 8,015,358	\$ 16,277	\$ —	\$ 8,031,635
Salaries and wages, payroll taxes, and taxes withheld from payroll	6,965,186	—	—	6,965,186
Accrued liabilities	6,319,677	—	—	6,319,677
Current portion of pension and other postretirement	3,553,200	—	—	3,553,200
Estimated third-party payor settlements	1,828,257	—	—	1,828,257
Due to affiliates	—	33,375	(33,375)	—
Current portion of long-term debt	2,443,472	—	—	2,443,472
Total current liabilities	29,125,150	49,652	(33,375)	29,141,427
Long-term debt and capital leases	67,193,532	—	—	67,193,532
Accrued pension and other postretirement liabilities	18,267,265	—	—	18,267,265
Self-insured professional liability	14,348,700	—	—	14,348,700
Estimated third-party payor settlements	15,639,566	—	—	15,639,566
Other liabilities	6,659,958	—	—	6,659,958
Net assets:				
Unrestricted	314,099,880	18,069	—	314,117,949
Temporarily restricted	3,305,592	—	—	3,305,592
Permanently restricted	8,067,466	—	—	8,067,466
Total net assets	325,472,938	18,069	—	325,491,007
Total liabilities and net assets	\$ 476,707,109	\$ 67,721	\$ (33,375)	\$ 476,741,455

The William W. Backus Hospital  
Consolidating Statement of Operations

Period From August 1, 2013 to September 30, 2013

	<b>The William W. Backus Hospital</b>	<b>Backus Medical Center Condominium Association, Inc.</b>	<b>Eliminations</b>	<b>Consolidated</b>
Operating revenues:				
Net patient service revenue	\$ 46,288,627			\$ 46,288,627
Provision for uncollectible accounts	(1,489,352)			(1,489,352)
Net patient service revenue less provision for uncollectible accounts	44,799,275			44,799,275
Other operating revenues	628,693	\$ 83,044	\$ (1,665)	710,072
Net assets released from restriction	28,253	-	-	28,253
	<u>45,456,221</u>	<u>83,044</u>	<u>(1,665)</u>	<u>45,537,600</u>
Operating expenses:				
Salaries and wages	19,188,089	-	-	19,188,089
Employee benefits	3,125,646	-	-	3,125,646
Supplies and other	8,606,513	-	-	8,606,513
Purchased services	7,551,716	83,044	(1,665)	7,633,095
Depreciation and amortization	2,684,973	-	-	2,684,973
Interest	557,418	-	-	557,418
	<u>41,714,355</u>	<u>83,044</u>	<u>(1,665)</u>	<u>41,795,734</u>
Operating income	3,741,866	-	-	3,741,866
Non-operating gains:				
Income from investments	1,287,032	-	-	1,287,032
Contributions	12,759	-	-	12,759
Other	1,600	-	-	1,600
Excess of revenues over expenses	<u>\$ 5,043,257</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,043,257</u>

The William W. Backus Hospital  
Consolidating Statement of Operations  
Period From October 1, 2012 to July 31, 2013

	<b>The William W. Backus Hospital</b>	<b>Backus Medical Center Condominium Association, Inc.</b>	<b>Eliminations</b>	<b>Consolidated</b>
Operating revenues:				
Net patient service revenue	\$ 230,444,135			\$ 230,444,135
Provision for uncollectible accounts	(7,234,583)			(7,234,583)
Net patient service revenue less provision for uncollectible accounts	223,209,552			223,209,552
Other operating revenues	6,328,025	\$ 415,634	\$ (19,977)	6,723,682
Net assets released from restriction	217,331	-	-	217,331
	<u>229,754,908</u>	<u>415,634</u>	<u>(19,977)</u>	<u>230,150,565</u>
Operating expenses:				
Salaries and wages	98,064,757	-	-	98,064,757
Employee benefits	23,754,968	-	-	23,754,968
Supplies and other	38,839,806	-	-	38,839,806
Purchased services	31,904,952	415,634	(19,977)	32,300,609
Depreciation and amortization	12,838,658	-	-	12,838,658
Interest	2,817,755	-	-	2,817,755
	<u>208,220,896</u>	<u>415,634</u>	<u>(19,977)</u>	<u>208,616,553</u>
Operating income	21,534,012	-	-	21,534,012
Non-operating gains and (losses):				
Income from investments	8,971,598	-	-	8,971,598
Contributions	124,881	-	-	124,881
Other	(140,249)	-	-	(140,249)
Excess of revenues over expenses	<u>\$ 30,490,242</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 30,490,242</u>

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