Consolidated Financial Statements and Supplementary Information

MidState Medical Center and Subsidiaries
Years Ended September 30, 2013 and 2012
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

MidState Medical Center and Subsidiaries

Consolidated Financial Statements
and Supplementary Information

Years Ended September 30, 2013 and 2012

Contents

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Report of Independent Auditors

Board of Directors
Hartford HealthCare Corporation

We have audited the accompanying consolidated financial statements of MidState Medical Center and Subsidiaries (the Hospital), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 consolidated financial position of MidState Medical Center and Subsidiaries at September 30, 2013 and 2012, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating balance sheet and consolidating statement of operations are presented for the 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 financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

January 31, 2014

MidState Medical Center and Subsidiaries

Consolidated Balance Sheets

	September 30 2013	2012
Assets		
Current assets:		
Cash and cash equivalents	**$ 28,465,876**	$ 47,972,840
Accounts receivable, less allowances for doubtful accounts of approximately $7,603,000 in 2013 and $8,764,000 in 2012	**27,767,137**	25,147,640
Other receivables	**7,456,493**	9,036,167
Estimated third-party payor settlements	**1,517,735**	–
Due from affiliates	**2,663,150**	6,319,474
Inventories of supplies	**2,719,853**	2,649,756
Prepaid expenses and other assets	**4,945,131**	2,789,213
Total current assets	**75,535,375**	93,915,090
Assets whose use is limited:		
Board-designated interest in investments held by Endowment LLC	**14,298,760**	–
Board-designated investments	**–**	13,032,246
Donor-restricted interest in investments held by Endowment LLC	**1,556,913**	–
Donor-restricted investments	**–**	1,887,592
Funds designated for debt service	**6,312,325**	6,312,325
	22,167,998	21,232,163
Funds held in trust by others	**13,953,158**	13,223,292
Unrestricted interest in investments held by Endowment LLC	**22,963,954**	–
Other assets	**15,996,488**	37,032,492
Property, plant, and equipment, net	**122,489,757**	127,788,769
Total assets	**$ 273,106,730**	$ 293,191,806
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 6,531,598**	$ 5,495,874
Salaries, wages, payroll taxes, and amounts withheld from employees	**9,070,645**	10,062,117
Accrued expenses	**6,820,898**	6,395,189
Estimated third-party payor settlements	**–**	3,562,417
Due to affiliates	**1,445,398**	–
Current portion of accrued pension liabilities	**6,336,706**	2,429,187
Current portion of long-term debt	**669,578**	–
Current portion of other liabilities	**121,733**	2,236,550
Total current liabilities	**30,996,556**	30,181,334
Long-term debt	**87,806,192**	88,731,315
Accrued pension liability	**18,941,059**	56,785,518
Other liabilities	**22,700,592**	26,866,681
Total liabilities	**160,444,399**	202,564,848
Net assets:		
Unrestricted	**95,882,676**	74,346,080
Temporarily restricted	**2,047,687**	2,279,087
Permanently restricted	**14,731,968**	14,001,791
Total net assets	**112,662,331**	90,626,958
Total liabilities and net assets	**$ 273,106,730**	$ 293,191,806

See accompanying notes.

MidState Medical Center and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended September 30	
	2013	**2012**
Unrestricted revenues, gains, and other support:		
Net patient service revenue	**$ 220,011,595**	$ 218,353,748
Provision for bad debts	**2,265,391**	6,461,499
Net patient service revenue less provision for bad debts	**217,746,204**	211,892,249
Other operating revenue	**18,894,548**	41,887,116
Net assets released from restrictions for operations	**245,321**	327,257
	236,886,073	254,106,622
Operating expenses:		
Salaries and wages	**76,115,980**	78,095,938
Employee benefits	**22,947,534**	28,749,594
Supplies and other	**43,513,564**	47,278,944
Purchased services	**61,587,299**	57,850,845
Depreciation and amortization	**13,310,897**	13,214,810
Provision for non-patient bad debts	**1,449,935**	8,498,226
Interest	**3,987,276**	3,996,300
	222,912,485	237,684,657
Operating income	**13,973,588**	16,421,965
Nonoperating income (loss):		
Income from investments, gifts, and bequests, net	**4,937,347**	1,448,167
Gain (loss) on interest rate swap	**586,303**	(1,587,712)
	5,523,650	(139,545)
Excess of revenues over expenses before change in unrealized gains and losses on investments	**19,497,238**	16,282,420
Change in unrealized gains and losses on investments	**(1,295,573)**	1,362,036
Excess of revenues over expenses	**18,201,665**	17,644,456

Continued on next page.

MidState Medical Center and Subsidiaries

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

	Year Ended September 30	
	2013	**2012**
Unrestricted net assets:		
Excess of revenues over expenses (continued)	**$ 18,201,665**	$ 17,644,456
Net assets released from restrictions for purchase of property and equipment	**163,712**	225,425
Change in pension funding obligation	**31,062,816**	(1,499,494)
Transfer to affiliates	**(27,888,900)**	–
Transfer to permanently restricted net assets	**(311)**	(311)
Other	**(2,386)**	–
Increase in unrestricted net assets	**21,536,596**	16,370,076
Temporarily restricted net assets:		
Restricted contributions	**423,136**	561,201
Restricted investment income	**85,487**	82,661
Return on investments held by Endowment LLC	**32,054**	–
Change in unrealized gains and losses on investments	**(1,109,094)**	220,990
Realized gains on investments	**746,050**	–
Net assets released from restrictions for operations	**(245,321)**	(327,257)
Net assets released from restrictions for purchase of property and equipment	**(163,712)**	(225,425)
(Decrease) increase in temporarily restricted net assets	**(231,400)**	312,170
Permanently restricted net assets:		
Transfer from unrestricted net assets	**311**	311
Change in unrealized gains and losses on funds held in trust by others	**729,866**	1,541,126
Increase in permanently restricted net assets	**730,177**	1,541,437
Increase in net assets	**22,035,373**	18,223,683
Net assets at beginning of year	**90,626,958**	72,403,275
Net assets at end of year	**$ 112,662,331**	$ 90,626,958

See accompanying notes.

MidState Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended September 30	
	2013	**2012**
Cash flows from operating activities		
Increase in net assets	**$ 22,035,373**	$ 18,223,683
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Noncash items:		
Depreciation and amortization	**13,310,897**	13,214,810
Change in unrealized gains and losses on investments	**2,404,667**	(1,583,026)
Change in investments held by Endowment LLC	**(2,210,280)**	–
Change in unrealized gains and losses on funds held in trust by others	**(729,866)**	(1,541,126)
Provision for patient bad debts	**2,265,391**	6,461,499
Provision for non-patient bad debts	**1,449,935**	8,498,226
Transfer to affiliates	**27,888,900**	–
Change in pension funding obligation	**(31,062,816)**	1,499,494
Change in fair value of interest rate swap	**(1,814,786)**	757,915
Other changes in net assets:		
Restricted contributions and investment income	**(508,623)**	(643,862)
Changes in operating assets and liabilities, net *(Note 12)*	**(6,960,958)**	(8,825,147)
Net cash provided by operating activities	**26,067,834**	36,062,466
Cash flows from investing activities		
Purchases of property, plant, and equipment, net	**(8,319,257)**	(8,773,144)
Purchases of unrestricted interest in investments held by Endowment LLC	**(21,426,224)**	–
Increase in assets whose use is limited, net	**(2,472,020)**	(835,259)
Net cash used in investing activities	**(32,217,501)**	(9,608,403)
Cash flows from financing activities		
Payments on long-term debt, net of premium amortization	**(255,545)**	(23,328)
Transfer to affiliates	**(13,610,375)**	–
Restricted contributions and investment income	**508,623**	643,862
Net cash (used in) provided by financing activities	**(13,357,297)**	620,534
(Decrease) increase in cash and cash equivalents	**(19,506,964)**	27,074,597
Cash and cash equivalents at beginning of year	**47,972,840**	20,898,243
Cash and cash equivalents at end of year	**$ 28,465,876**	$ 47,972,840

See accompanying notes.

1. Significant Accounting Policies

The accounting policies that affect significant elements of the MidState Medical Center and Subsidiaries' (collectively referred to as the Hospital), consolidated financial statements are summarized below and in Note 2.

Organization

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

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

Effective February 14, 2006, MidState MSO, LLC (a wholly-owned subsidiary of the Hospital) was created to provide management services and support for medical practices. MidState MSO, LLC ceased operations effective December 31, 2012. These services are now performed by Hartford HealthCare Medical Group effective January 1, 2013.

The accompanying consolidated financial statements include the Center and MidState MSO, LLC. All material intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

Use of Estimates

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

Regulatory Matters

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

1. Significant Accounting Policies (continued)

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 and Cash Equivalents

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

Patient Accounts Receivable

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

The Hospital's primary concentration of credit risk is patient accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies, and private patients. The Hospital manages the receivables by regularly reviewing its patient accounts and contracts and by providing appropriate allowances for uncollectible amounts. Significant concentrations of gross patient accounts receivable include 32% and 12%, and 36% and 13%, for Medicare and Medicaid, respectively, for the fiscal years ended September 30, 2013 and 2012, respectively.

1. Significant Accounting Policies (continued)

Interest in Investments Held by Hartford HealthCare Endowment LLC

Effective August 29, 2011, Hartford HealthCare Endowment LLC (Endowment LLC) was created to maintain and manage, on a pooled basis, the endowment funds of the Hospital; Windham Community Memorial Hospital, Inc.; Harford Hospital; The Hospital of Central Connecticut at New Britain General and Bradley Memorial; HHC; and Hartford HealthCare at Home, Inc. Endowment LLC, a wholly owned subsidiary of HHC, acts as manager, and is named fiduciary for HHC within established investment guidelines. As of April 1, 2013, $36,609,346 of the Hospital's investments were sold to Endowment LLC, at which time all previously unrealized gains and losses on the sold investments were realized. As of September 30, 2013, the Hospital has an interest in investments held by Endowment LLC, which is reflected in the accompanying consolidated balance sheets and represents the Hospital's pro rata share of Endowment LLC.

The Hospital reports its share of the increase or decrease in Endowment LLC as income or loss from investments in the excess of revenues over expenses, unless the income or loss is restricted by donor or law. Investments held by Endowment LLC in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations at the consolidated balance sheet date. Alternative investments (nontraditional, not-readily-marketable assets), some of which are structured such that Endowment LLC holds limited partnership interests, are reported based upon net asset value and derived from the application of the equity method of accounting. Individual investment holdings within the alternative investments may, in turn, include investments in both nonmarketable and market-traded securities. Valuations of these investments and, therefore, Endowment LLC's holdings may be determined by the investment manager or general partner and for "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. Endowment LLC accounts for these investments using the equity method of accounting and reports its share of the increase or decrease in the funds' value as investment gain or loss. The financial statements of the investees are audited annually by independent auditors, although the timing for reporting the results of such audits does not coincide with Endowment LLC's annual consolidated financial statement reporting.

1. Significant Accounting Policies (continued)

Investments

Prior to April 1, 2013, the Hospital's investment portfolio was classified as trading, with unrealized gains and losses included in the excess of revenues over expenses. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations at the balance sheet date. Assets temporarily and permanently restricted (by donor) are recorded at fair value at the date of donation, which is then considered cost. Investment income (including realized gains and losses on investments, interest and dividends, and the change in unrealized gains and losses) is included in nonoperating income unless the income or loss is restricted by the donor or law. The cost of securities sold is based on the specific identification method.

Inventories

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

Property, Plant, and Equipment

Property, plant, and equipment are stated on the basis of cost. The Hospital provides for depreciation of property, plant and equipment and assets under capital leases using the straight-line method in amounts sufficient to depreciate the cost of the assets over their estimated useful lives, which range from 3 to 40 years.

Assets Whose Use is Limited

Assets whose use is limited includes assets that are set aside internally by management or by the Board of Directors for future capital improvements, research, donor-restricted assets, education, escrow funds, and debt service funds for existing obligations on outstanding long-term debt. Amounts that are restricted by the Board of Directors are not available for use without the approval of the Board of Directors. Restricted investment income in excess of a predetermined spending limit has also been set aside as long-term investments.

1. Significant Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those assets 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 and are 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 expendable to support healthcare services, and the assets are classified as permanently restricted.

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

Donor-Restricted Gifts

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

Bond Issuance Costs

Bond issuance costs associated with long-term debt for capital projects are amortized over the term of the debt using a method that approximates the effective interest method. Bond issuance costs of $1,664,301 and $1,742,044 are recorded in other assets in the consolidated balance sheets as of September 30, 2013 and 2012, respectively.

1. Significant Accounting Policies (continued)

Interest Rate Swap Agreements

The Hospital utilizes interest rate swap agreements to reduce risks associated with changes in interest rates. The Hospital does not hold or issue derivative financial instruments for trading purposes. The Hospital may be exposed to credit loss in the event of nonperformance by the counterparties to its interest rate swap agreements. Interest rate swap agreements are reported at fair value. Changes in fair value are recognized in the performance indicator in the consolidated statements of operations and changes in net assets.

Other Operating Revenue

Other operating revenue includes services to other institutions, electronic health record incentive program revenue, rental income, grant income, research income, and unrestricted contributions.

Nonoperating Income

Nonoperating income includes income on investments, realized and unrealized gains and losses on trading investments, restricted gifts, bequests, and changes in the fair value of the swap agreement.

Excess of Revenues over Expenses

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

Professional Liability Insurance

Coverage for medical malpractice insurance is provided on a claims-made basis. The primary coverage is with CHS Insurance Limited (CHS), a captive insurance company that, effective October 1, 2012, became a wholly owned subsidiary of HHC. Prior to this the Hospital had a 25% ownership interest, which was repurchased by CHS and transferred to HHC. For the year ended September 30, 2012, the Hospital’s ownership was accounted for under the equity method

1. Significant Accounting Policies (continued)

Professional Liability Insurance (continued)

and was included in other assets in the accompanying consolidated balance sheets. The Hospital's share of the investment activity of CHS was included in other operating revenue within the accompanying consolidated statement of operations and changes in net assets and was $17,840,000 for the year ended September 30, 2012. As a result of the repurchase, the Hospital's equity investment of approximately $13,893,500 was derecognized, and $20,344,669 of unrestricted net assets were transferred to HHC during 2013 to recapitalize CHS. This is reflected in the consolidated statements of operations and changes in net assets within transfer to affiliates.

On October 1, 2012, the policy limits were amended. The primary coverage went from $10,000,000 per claim and $39,000,000 in the aggregate to $7,500,000 per claim and $35,000,000 in the aggregate. The excess plan was restructured as well. The primary layer of $20,000,000 is shared with two insurance carriers. The secondary layer is $20,000,000 with a single insurance carrier. The third and fourth layers are $10,000,000 each with two other insurance carriers, for a total excess coverage of $60,000,000.

Malpractice claims are discounted at 2.08% and 2.49% and the incurred-but-not-reported liability was approximately $2,774,000 and $3,385,000 at September 30, 2013 and 2012, respectively.

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 Center is an S Corporation, a pass-through entity not subject to federal income taxes. MidState MSO is a single member limited liability company treated as part of its sole member for federal tax purposes.

Electronic Health Record Incentive Program

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

1. Significant Accounting Policies (continued)

Electronic Health Record Incentive Program (continued)

The Medicare EHR incentive program provides annual incentive payments to eligible professionals, hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology. The Hospital uses a grant accounting model to recognize EHR incentive revenues. EHR incentive revenues are recognized ratably over the relevant cost report period to determine the amount of reimbursement. The Hospital recognized $2,003,248 and $2,417,477 of EHR revenues during the fiscal years ended September 30, 2013 and 2012, respectively. Correspondingly, the Medicare and Medicaid components, respectively, of EHR revenues are $1,605,290 and $397,958, and $1,754,215 and $663,262 for 2013 and 2012, respectively. EHR incentive revenues are included in other operating revenues in the accompanying consolidated statements of operations and changes in net assets.

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

New Accounting Pronouncement

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, to amend the requirement for measuring and disclosing information about fair value that results in common principles between GAAP and International Financial Reporting Standards (IFRSs). The amendments clarify the FASB's intent about the application of existing fair value measurement and disclosure requirements and change particular principles and requirements for measuring or disclosing information about fair value. Principles changed include measuring fair value of financial instruments that are managed within a portfolio, application of premiums and discounts in the fair value measurement, and additional disclosures about fair value measurements. The standard became effective for the Hospital for annual reporting periods beginning after December 15, 2011. The Hospital adopted the provisions of this standard on October 1, 2012. The adoption had no effect on previously reported excess of revenues over expenses or net assets.

1. Significant Accounting Policies (continued)

Reclassifications

Certain reclassifications have been made to the fiscal year ended September 30, 2012, balances previously reported in the consolidated balance sheet and statement of operations and changes in net assets in order to conform with the fiscal year ended September 30, 2013, presentation.

2. Net Patient Service Revenue and Charity Care

Revenues from the Medicare and Medicaid programs, respectively, accounted for approximately 36% and 13%, and 37% and 11% of the Hospital's net patient service revenue for the fiscal years ended September 30, 2013 and 2012, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

The 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. 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 following table summarizes net revenue from services to patients:

	Year Ended September 30	
	2013	**2012**
Gross revenues from patients:		
Inpatients	**$ 219,546,008**	$ 212,045,748
Outpatients	**285,501,650**	267,599,887
	505,047,658	479,645,635
Deductions:		
Allowances and discounts	**277,904,920**	257,058,291
Charity care	**7,131,143**	4,233,596
Net patient service revenue	**220,011,595**	218,353,748
Provision for bad debts	**2,265,391**	6,461,499
Net patient service revenue less provision for bad debts	**$ 217,746,204**	$ 211,892,249

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

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 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. During 2013 and 2012, the Hospital recorded net changes in estimates of $1,774,811 and $3,087,525 respectively, which primarily related to better than previously estimated third-party payor settlements.

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 consolidated 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.

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

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

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

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

- Revenue and volume trends by payor, particularly the self-pay components.
- Changes in the aging and payor mix of accounts receivable, including increased focus on accounts due from the uninsured and accounts that represent co-payments and deductibles due from patients.
- Various allowance coverage statistics.

The Hospital regularly performs hindsight procedures to evaluate historical write-off and collection experience throughout the year to help determine the reasonableness of its process for estimating the allowance for doubtful accounts.

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

Patient service revenue, net of contractual allowances and discounts and before the provision for bad debts, recognized in the period from major payor sources for the fiscal years ended September 30, 2013 and 2012, is as follows:

	2013	**2012**
Medicare	**33%**	34%
Medicaid	**12**	11
Self-pay	**5**	4
All other	**50**	51
	100%	100%

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

The estimated cost of charity care provided was $2,919,787 and $1,792,275 for the fiscal years ended September 30, 2013 and 2012, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

3. Net Assets

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

	2013	2012
Free beds	**$ 139,793**	$ 135,854
Other health care services	**1,907,894**	2,143,233
	$ 2,047,687	$ 2,279,087

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 services	**$ 642,970**	$ 642,970
Endowment requiring income to be added to original gift to support health care services	**135,840**	135,529
Restricted funds held in trust by others, the income from which is expendable to support health care services	**13,953,158**	13,223,292
	$ 14,731,968	$ 14,001,791

3. Net Assets (continued)

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

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

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

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

3. Net Assets (continued)

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 alternative investments to achieve its long-term objectives within prudent risk constraints.

The Hospital's spending policy is that investment income and realized gains and losses associated with the endowments are appropriated for spending. This is consistent with the Hospital's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment returns. The Hospital also evaluated endowment spending based on need and current market conditions as well as long-term investment goals.

Endowment net asset composition by type (excluding funds held in trust by others) of fund as of September 30, 2013, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ –	$ 778,103	$ 778,810	$ 1,556,913
Board-designated endowment funds	14,298,760	–	–	14,298,760
	$ 14,298,760	$ 778,103	$ 778,810	$ 15,855,673

3. Net Assets (continued)

Changes in endowment funds for the fiscal year ended September 30, 2013, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 13,032,246	$ 1,109,093	$ 778,499	$ 14,919,838
Reclassifications	(311)	–	311	–
Endowment net assets after reclassification	13,031,935	1,109,093	778,810	14,919,838
Investment return:				
Investment income	359,969	–	–	359,969
Net appreciation/(depreciation) (realized and unrealized)	1,126,574	(330,990)	–	795,584
Total investment return	1,486,543	(330,990)	–	1,155,553
Appropriation of endowment assets for expenditure	(219,718)	–	–	(219,718)
Endowment net assets, end of year	$ 14,298,760	$ 778,103	$ 778,810	$ 15,855,673

Endowment net asset composition (excluding funds held in trust by others) by type of fund as of September 30, 2012, consisted of the following:

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

3. Net Assets (continued)

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

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

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor, as stipulated by UPMIFA, requires the Hospital to retain as a fund of perpetual duration. These deficiencies periodically result from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions, in which case the Board of Directors may deem imprudent the continuation of appropriation for a limited period. There were no material deficiencies as of September 30, 2013 and 2012.

4. Assets Whose Use is Limited

Included in assets whose use is limited are the following amounts:

	September 30	
	2013	**2012**
Cash and cash equivalents	**$ –**	$ 390,727
Money market funds	**6,312,325**	6,312,325
Interest in investments held by Endowment LLC	**15,855,673**	–
Domestic equity securities	**–**	7,465,517
Domestic fixed income securities	**–**	2,570,999
Mutual funds:		
U.S.	**–**	3,004,687
International	**–**	1,255,708
Other	**–**	232,200
	$ 22,167,998	$ 21,232,163

During 2013, a significant portion of the Hospital's assets whose use is limited was transferred to Endowment LLC, as discussed in Note 1.

The composition and presentation of income from investments, gifts, and bequests, net, which are included in nonoperating income in the consolidated statements of operations and changes in net assets, are as follows:

	Year Ended September 30	
	2013	**2012**
Interest and dividend income	**$ 51,290**	$ 92,372
Return on interest in investments held by Endowment LLC	**2,178,226**	–
Realized gain on investments, net	**2,707,831**	1,355,795
	$ 4,937,347	$ 1,448,167

5. Fair Values of Financial Instruments

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

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

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

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

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

5. Fair Values of Financial Instruments (continued)

Financial assets and liabilities carried at fair value in the accompanying consolidated balance sheets, excluding assets invested in the Hospital's defined benefit pension plan and Endowment LLC, are classified in the following tables below in one of the three categories described above:

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 28,465,876	$ –	$ –	$ 28,465,876
Assets whose use is limited:				
Money market funds	6,312,325	–	–	6,312,325
Funds held in trust by others	–	13,953,158	–	13,953,158
Other assets:				
Money market funds	1,500,643	–	–	1,500,643
	$ 36,278,844	$ 13,953,158	$ –	$ 50,232,002
Liabilities				
Interest rate swap agreements	$ –	$ 4,663,973	$ –	$ 4,663,973

The Hospital has $38,819,627 of financial assets as of September 30, 2013, that are held by Endowment LLC (refer to Note 1). Financial assets classified within the trust are 63.8% Level 1 and 36.2% Level 2.

5. Fair Values of Financial Instruments (continued)

	September 30, 2012			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 47,972,840	$ –	$ –	$ 47,972,840
Assets whose use is limited:				
Cash and cash equivalents	390,727	–	–	390,727
Money market funds	6,312,325	–	–	6,312,325
Domestic equity securities	7,465,517	–	–	7,465,517
Domestic fixed income bonds	–	2,570,999	–	2,570,999
Mutual funds:				
U.S.	3,004,687	–	–	3,004,687
International	1,255,708	–	–	1,255,708
Other	–	232,200	–	232,200
Funds held in trust by others	–	13,223,292	–	13,223,292
Other assets:				
Money market funds	1,000,330	–	–	1,000,330
	$ 67,402,134	$ 16,026,491	$ –	$ 83,428,625
Liabilities				
Interest rate swaps	$ –	$ 6,478,759	$ –	$ 6,478,759

Financial assets carried at fair value included in the cash balance retirement plan are held in an HHC master trust. The Hospital owns participant units in the trust. Financial assets classified within the trust are 53.4% Level 1, 34.4% Level 2, and 12.2% Level 3 as of September 30, 2013 and 43.3% Level 1, 45.4% Level 2 and 11.3% Level 3 as of September 30, 2012.

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

5. Fair Values of Financial Instruments (continued)

The methods described above may produce a fair value that may not indicate net realizable value or reflect future fair values. Furthermore, while the Hospital believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

6. Property, Plant, and Equipment

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

	2013	2012
Land and land improvements	**$ 9,533,536**	$ 9,533,536
Buildings and building improvements	**114,574,600**	114,596,821
Equipment	**131,331,273**	128,867,777
	255,439,409	252,998,134
Less accumulated depreciation	**(134,829,314)**	(126,840,826)
	120,610,095	126,157,308
Construction in process (estimated cost to complete - $856,000)	**1,879,662**	1,631,461
	$ 122,489,757	$ 127,788,769

7. Pensions and Other Postretirement Benefits

The Hospital has a defined benefit pension plan, covering substantially all of its employees and executives, and a noncontributory, supplemental defined-benefit retirement plan for certain executive employees (collectively, the pension plans). Contributions to the pension plans are based on actuarially determined amounts sufficient to meet the benefits to be paid to the plan participants. The assets of the pension plans are available to pay the benefits of eligible employees for participating entities based on their allocated share of assets. The service cost component of net periodic pension cost and all other components are actuarially determined as defined by each plan.

7. Pensions and Other Postretirement Benefits (continued)

The benefits are based on years of service and the employees' compensation during the last five years of employment. The Hospital makes contributions in amounts sufficient to fund the pension plans' current service cost, and the funding policy is to contribute amounts to these plans sufficient to meet the minimum funding requirements set forth by federal government regulations.

The Hospital has a defined contribution plan. Pension expense for the defined contribution plan was $4,553,951 and $3,175,437 for the fiscal years ended September 30, 2013 and 2012, respectively.

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

	2013	2012
Unrecognized actuarial loss	**$ 36,767,516**	$ 67,818,414
Unrecognized prior service credit	**11,918**	23,836
	$ 36,779,434	$ 67,842,250

The prior service credit and actuarial loss included in unrestricted net assets and expected to be recognized in net periodic pension cost during the fiscal year ending September 30, 2014, is $1,241,483.

7. Pensions and Other Postretirement Benefits (continued)

The following table sets forth the defined benefit pension plan's funded status and amounts recognized in the Hospital's consolidated balance sheets:

	September 30 2013	September 30 2012
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 182,311,921**	$ 159,849,082
Service cost	**1,475,253**	3,747,666
Interest cost	**7,335,308**	8,188,049
Benefits paid	**(6,055,908)**	(4,920,982)
Curtailment	**–**	(11,786,867)
Plan amendments	**–**	23,836
Actuarial (loss) gain	**(19,425,679)**	27,211,137
Benefit obligation at end of year	**165,640,895**	182,311,921
Change in plan assets		
Fair value of plan assets at beginning of year	**125,526,403**	102,099,747
Actual return on plan assets	**18,035,388**	19,647,638
Benefits paid	**(6,055,908)**	(4,920,982)
Employer contribution	**6,587,000**	8,700,000
Fair value of plan assets at end of year	**144,092,883**	125,526,403
Underfunded status of the plan	**$ (21,548,012)**	$ (56,785,518)
Components of net periodic benefit cost		
Service cost	**$ 1,475,253**	$ 3,747,666
Interest cost	**7,335,308**	8,188,049
Expected return on plan assets	**(9,096,993)**	(9,131,984)
Curtailment	**11,918**	(884,957)
Net amortization and deferral	**2,686,824**	4,317,914
Net periodic benefit cost	**$ 2,412,310**	$ 6,236,688

7. Pensions and Other Postretirement Benefits (continued)

The accumulated benefit obligation for the pension plans was $165,601,972 and $181,652,205 as of September 30, 2013 and 2012, respectively.

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

The weighted-average assumptions used to develop net periodic benefit cost and the projected benefit obligation were as follows:

	September 30	
	2013	**2012**
Discount rate for determining benefit obligation at year-end	**4.95%**	4.05%
Rate of compensation increase	**3.50%**	3.50%
Discount rate for net periodic benefit cost	**4.05%**	5.25%
Expected rate of return on plan assets	**7.50%**	8.00%

The expected rate of return on assets was determined by the expected return on each asset class based on a model that considers historical and expected future performance.

7. Pensions and Other Postretirement Benefits (continued)

Plan Assets

The Hospital's pension plans weighted-average asset allocations at September 30, by asset category, are as follows:

Asset Category	Target	2013	2012
Equity securities	**57%**	**60%**	41%
Fixed income/debt securities	**25**	**24**	14
Commodities/inflation/real assets	**8**	**6**	34
Other	**10**	**10**	11
Total	**100%**	**100%**	100%

The pension plan asset portfolio has target allocations similar to the allocations noted in the table above. The goals of the plans are to provide a secure retirement benefit for plan participants and to manage pension plan assets for the exclusive benefit of the participants. The Investment Committee of the Board of Directors is responsible for developing, reviewing, and monitoring the investment policy. The plans' assets are invested in accordance with the policy.

Contributions

The Hospital expects to make contributions of approximately $7.4 million and $5.1 million in fiscal year 2014 related to its defined benefit pension plan and defined contribution plans, respectively.

7. Pensions and Other Postretirement Benefits (continued)

Estimated Future Benefit Payments

Future benefit payments are expected to be paid as follows:

Fiscal Year	Pension Benefits
2014	$ 8,714,002
2015	6,717,824
2016	7,393,749
2017	8,103,700
2018	8,692,068
Years 2019 – 2023	51,278,178

8. Long-Term Debt

Details of long-term debt are as follows:

	September 2013	
	2013	**2012**
Intercompany debt with HHC:		
Series A, consisting of a tax-exempt serial bond and term bonds; interest at rates ranging from 4.4% to 5.0%	**$ 81,871,574**	$ 82,094,766
Series C, taxable variable rate term bond	**5,032,987**	5,032,987
Premium on bonds	**1,571,209**	1,603,562
	88,475,770	88,731,315
Less current portion	**(669,578)**	–
	$ 87,806,192	$ 88,731,315

8. Long-Term Debt (continued)

On September 29, 2011, HHC issued approximately $375,815,000 of CHEFA Revenue Bonds Series A, B, and C (the HHC 2011 Bonds). In conjunction with the issuance of the HHC 2011 Bonds, an obligated group was formed. The members of the obligated group are HHC, Hartford Hospital, The Hospital of Central Connecticut at New Britain General and Bradley Memorial, Windham Community Memorial Hospital, and MidState Medical Center (collectively referred to as the Obligated Group). Obligated Group members are jointly and severally liable under a Master Trust Indenture (MTI) to make all payments required with respect to obligations under the MTI. HHC does have the right to name designated affiliates, although presently none exist. Though designated affiliates are not obligated to make debt service payments on the obligations under the MTI, each designated affiliate has an independent designated affiliate agreement and promissory note with HHC with stipulated repayment terms and conditions, each subject to the governing law of the Obligated Groups' state of incorporation. In addition, HHC may cause each designated affiliate to transfer such amounts as necessary to enable the Obligated Group members to comply with the terms of the MTI, including payment of the outstanding obligations.

The HHC 2011 Bonds were issued to refund portions of existing debt under HHC and to obtain funds for future capital needs. As such, the HHC 2011 Bonds are reflected as intercompany debt in the preceding schedule. The Hospital is party to the HHC Series A and Series C Revenue Bonds. The HHC Series A Revenue Bonds consist of serial bonds that mature annually from July 1, 2014 through July 1, 2023, and the term bonds mature from July 1, 2024 through July 1, 2041. During 2013, the Hospital made advance payments of $223,192 to HHC for the bonds maturing in 2014. The HHC Series C Revenue Bonds consist of term bonds that mature from July 1, 2042 through July 1, 2049. The HHC Series C Revenue Bonds are secured by an irrevocable letter of credit issued by JP Morgan Chase Bank that expires on October 1, 2016. The reimbursement terms of the letters of credit for the HHC Series C Revenue Bonds are such that in the event a letter of credit is drawn upon due to a failed remarketing, the components available shall equal the aggregate principal and interest amount of bonds outstanding.

The MTI and Supplemental MTI provide for the potential establishment and maintenance of a debt service reserve fund, a pledge of gross receipts, as defined, and parity with the HHC Series A Revenue Bonds that remain outstanding. The MTI and loan agreements establish certain restrictive covenants, including debt service coverage ratio and days cash on hand requirement. No violations of covenants existed as of or for the fiscal years ended September 30, 2013 or 2012.

8. Long-Term Debt (continued)

The fair value of the HHC 2011 Bonds was approximately $377,885,000 and $396,836,000 at September 30, 2013 and 2012, respectively. The carrying value of the HHC 2011 Bonds was $375,815,000 as of September 30, 2013 and 2012. The fair value of the HHC 2011 Bonds was determined by HHC's investment advisor using a market approach that uses prices and other relevant information generated by market transactions involving identical or comparable liabilities and categorized as Level 2 in the fair value hierarchy described in Note 5.

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

The fair value of the swap agreement was $4,663,973 and $6,478,759 at September 30, 2013 and 2012, respectively, and is recorded in other liabilities in the accompanying consolidated balance sheets. Although the LIBOR Swap represents an economic hedge of the interest rate on debt, it does not qualify for hedge accounting. The change in the fair market value of this agreement is reported in the accompanying consolidated statements of operations and changes in net assets as a component of income from investments along with the net cash receipts on the swap agreement.

As part of the HHC 2011 Bonds, the Obligated Group entered into a new line of credit for $20,000,000 from Bank of America. This line expires in March 2014. In 2012, the Obligated Group entered into an additional $60,000,000 line of credit with another bank. In August 2013, the Obligated Group entered into an amendment increasing this line of credit to $100,000,000. This line of credit expires in March 2014. As of September 30, 2013, and 2012, the Hospital had not drawn on either line of credit.

8. Long-Term Debt (continued)

Principal payments due on long-term debt are as follows:

Fiscal year ending September 30:	
2014	$ 669,578
2015	1,010,352
2016	1,208,556
2017	1,302,017
2018	1,443,821
Thereafter	81,270,237
	$ 86,904,561

Interest paid for the fiscal years ended September 30, 2013 and 2012, was $3,987,276 and $3,996,300, respectively.

9. Commitments and Contingencies

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 1 or are deemed to be immaterial. While the outcomes of the lawsuits cannot be determined at this time, management believes that any loss that may arise from these actions will not have a material adverse effect on the financial position or changes in net assets of the Hospital.

Hospital employees covered by collective bargaining agreements represent approximately 29% of total employees as of both September 30, 2013 and 2012. These employees are part of the Connecticut Health Care Associates, National Union of Hospital & Healthcare Employees AFSCME AFL-CIO, whose contract is due to expire in September of 2014.

The Hospital has several operating lease agreements for certain real estate, medical equipment, and computer equipment. Certain of these leases have renewal options for periods up to five years and escalation clauses. Rent is payable in equal monthly installments. Rent expense was $3,903,677 and $3,731,807 for the years ended September 30, 2013 and 2012, respectively.

9. Commitments and Contingencies (continued)

The future minimum lease payments are as follows:

2014	$ 2,396,539
2015	2,148,980
2016	1,958,906
2017	1,839,034
2018	1,698,284
Thereafter	10,030,503
	$ 20,072,246

10. Related-Party Transactions

The Hospital obtains services from various HHC affiliates that are recorded at cost that represent an allocation of shared expenditures. Services provided by affiliates for the fiscal years ended September 30, 2013 and 2012, were $47,699,466 and $41,288,536, respectively. The Hospital also provides services to certain of its affiliates and is reimbursed for the cost of these services. Fees charged to affiliates for the fiscal years ended September 30, 2013 and 2012, which are included in other operating revenue in the consolidated statements of operations and changes in net assets, were approximately $637,951 and $203,264, respectively. Other intercompany activity with subsidiaries of the Hospital includes recurring transactions associated with operations and cash management, which have been eliminated in consolidation.

10. Related-Party Transactions (continued)

Amounts due from affiliates related to these services as of September 30 are as follows:

	2013	2012
Due from Hartford Hospital	**$ –**	$ 6,319,474
Due from HHC	**2,287,478**	–
Due from PracticeCentral	**328,905**	–
Due from Hartford HealthCare Medical Group	**46,767**	–
	$ 2,663,150	$ 6,319,474

Amounts due to affiliates related to these services as of September 30 are as follows:

	2013	2012
Due to Hartford Hospital	**$ 1,386,207**	$ –
Due to Eastern Rehabilitation Network	**59,191**	–
	$ 1,445,398	$ –

11. Functional Expenses

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

	Year Ended September 30	
	2013	2012
Health care services	**$ 197,500,462**	$ 210,588,606
Support services	**25,412,023**	27,096,051
	$ 222,912,485	$ 237,684,657

12. Supplemental Cash Flow Information

The changes in assets and liabilities are as follows:

	Year Ended September 30	
	2013	**2012**
Increase in accounts receivable	**$ (4,884,888)**	$ (7,932,285)
Decrease (increase) in other receivables	**129,739**	(10,213,471)
Decrease (increase) in due to (from) affiliates, net	**5,101,722**	(6,319,474)
Increase in inventories of supplies and prepaid expenses and other assets	**(2,421,947)**	(916,421)
Decrease (increase) in other assets	**7,064,851**	(8,815,457)
Increase in accounts payable	**1,035,724**	1,518,097
(Decrease) increase in estimated third-party payor settlements	**(5,080,152)**	1,761,887
(Decrease) increase in salaries, wages, payroll taxes, and amounts withheld from employees	**(991,472)**	977,272
Increase in other accrued expenses	**425,709**	5,883,402
Decrease in other current liabilities	**(2,114,817)**	(403,450)
(Decrease) increase in other long-term liabilities	**(2,351,303)**	18,712,898
Decrease in accrued pension liabilities	**(2,874,124)**	(3,078,145)
	$ (6,960,958)	$ (8,825,147)

13. Subsequent Events

The Hospital evaluated subsequent events through January 31, 2014, which is the date the consolidated financial statements were issued, for potential recognition in the consolidated financial statements as of the balance sheet date for the fiscal year ended September 30, 2013. No events occurred that require disclosure or adjustment to the consolidated financial statements.

Supplementary Information

MidState Medical Center and Subsidiaries

Consolidating Balance Sheet

September 30, 2013

	MidState Medical Center	Meriden Imaging Center, Inc.	Total	Eliminating Entries	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 27,158,493	$ 1,307,383	$ 28,465,876		28,465,876
Accounts receivable, less allowances	27,767,137	–	27,767,137		27,767,137
Other receivables	6,718,647	737,846	7,456,493		7,456,493
Estimated third-party payor settlements	1,517,735	–	1,517,735		1,517,735
Due from affiliates	2,663,150	–	2,663,150		2,663,150
Inventories of supplies	2,719,853	–	2,719,853		2,719,853
Prepaid expenses and other assets	4,878,472	66,659	4,945,131		4,945,131
Total current assets	73,423,487	2,111,888	75,535,375		75,535,375
Assets whose use is limited:					
Board-designated interest in investments held by Endowment LLC	14,298,760	–	14,298,760		14,298,760
Donor-restricted interest in investments held by Endowment LLC	1,556,913	–	1,556,913		1,556,913
Funds designated for debt service	6,312,325	–	6,312,325		6,312,325
	22,167,998	–	22,167,998		22,167,998
Funds held in trust by others	13,953,158	–	13,953,158		13,953,158
Unrestricted interest in investments held by Endowment LLC	22,963,954	–	22,963,954		22,963,954
Other assets	18,580,095	650	18,580,745	$ (2,584,257)	15,996,488
Property, plant, and equipment, net	122,016,039	473,718	122,489,757	–	122,489,757
Total assets	$ 273,104,731	$ 2,586,256	$ 275,690,987	$ (2,584,257)	$ 273,106,730
Liabilities and net assets					
Current liabilities:					
Accounts payable	$ 6,292,073	$ 239,525	$ 6,531,598		6,531,598
Salaries, wages, payroll taxes, and amounts withheld from employees	9,070,645	–	9,070,645		9,070,645
Accrued expenses	6,549,869	271,029	6,820,898		6,820,898
Due to affiliates	1,445,398	–	1,445,398		1,445,398
Current portion of accrued pension liabilities	6,336,706	–	6,336,706		6,336,706
Current portion of long-term debt	669,578	–	669,578		669,578
Current portion of other liabilities	121,733	–	121,733		121,733
Total current liabilities	30,486,002	510,554	30,996,556		30,996,556
Long-term debt	87,806,192	–	87,806,192		87,806,192
Accrued pension liability	18,941,059	–	18,941,059		18,941,059
Other liabilities	22,285,452	–	22,285,452	$ 415,140	22,700,592
Total liabilities	159,518,705	510,554	160,029,259	415,140	160,444,399
Net assets:					
Unrestricted	96,806,371	2,075,702	98,882,073	(2,999,397)	95,882,676
Temporarily restricted	2,047,687	–	2,047,687	–	2,047,687
Permanently restricted	14,731,968	–	14,731,968	–	14,731,968
Total net assets	113,586,026	2,075,702	115,661,728	(2,999,397)	112,662,331
Total liabilities and net assets	$ 273,104,731	$ 2,586,256	$ 275,690,987	$ (2,584,257)	$ 273,106,730

MidState Medical Center and Subsidiaries

Consolidating Statement of Operations

Year Ended September 30, 2013

	MidState Medical Center	Meriden Imaging Center, Inc.	MidState MSO, LLC	Total	Eliminating Entries	Consolidated
Net patient service revenue	$ 220,011,595			$ 220,011,595		$ 220,011,595
Provision for bad debts	2,265,391			2,265,391		2,265,391
Net patient service revenue less provision for bad debts	217,746,204			217,746,204		217,746,204
Other operating revenue	8,871,000	$ 7,800,959	$ 2,149,935	18,821,894	$ 72,654	18,894,548
Net assets released from restrictions for operations	245,321	–	–	245,321	–	245,321
	226,862,525	7,800,959	2,149,935	236,813,419	72,654	236,886,073
Operating expenses:						
Salaries and wages	75,257,780	–	858,200	76,115,980		76,115,980
Employee benefits	22,649,817	–	297,717	22,947,534		22,947,534
Supplies and other	40,851,392	1,922,731	739,441	43,513,564		43,513,564
Purchased services	54,669,627	6,065,783	851,889	61,587,299		61,587,299
Depreciation and amortization	13,104,256	175,714	30,927	13,310,897		13,310,897
Provision for non-patient bad debts		–	1,449,935	1,449,935		1,449,935
Interest	3,987,276	–	–	3,987,276		3,987,276
	210,520,148	8,164,228	4,228,109	222,912,485		222,912,485
Operating income (loss)	16,342,377	(363,269)	(2,078,174)	13,900,934	72,654	13,973,588
Nonoperating income:						
Income from investments, gifts, and bequests, net	4,937,347	–	–	4,937,347		4,937,347
Gain on interest rate swap	586,303	–	–	586,303		586,303
	5,523,650	–	–	5,523,650		5,523,650
Excess (deficiency) of revenues over expenses before change in unrealized gains and losses on investments	21,866,027	(363,269)	(2,078,174)	19,424,584	72,654	19,497,238
Change in unrealized gains and losses on investments	(1,295,573)	–	–	(1,295,573)	–	(1,295,573)
Excess (deficiency) of revenues over expenses	$ 20,570,454	$ (363,269)	$ (2,078,174)	$ 18,129,011	$ 72,654	$ 18,201,665

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