FINANCIAL STATEMENTS

The Milford Hospital, Incorporated
Years Ended September 30, 2013 and 2012
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

The Milford Hospital, Incorporated

Financial Statements

Years Ended September 30, 2013 and 2012

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Report of Independent Auditors

The Board of Directors
The Milford Hospital, Incorporated

We have audited the accompanying financial statements of The Milford Hospital, Incorporated (the Hospital), which comprise the balance sheets as of September 30, 2013 and 2012, and the related statements of operations and changes in net assets and cash flows for the years then ended, 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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Milford Hospital, Incorporated at September 30, 2013 and 2012, and the results of its operations and changes in net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Transaction

As more fully explained in Note 1 to the accompanying financial statements, in September 2014, the Hospital completed a significant transaction with another health care provider that will utilize beds at the Hospital under a lease agreement and furnished the Hospital with a term loan to provide additional liquidity. The term loan agreement requires the Hospital to comply with certain financial covenants. Our opinion is not modified with respect to this matter.

Change in Presentation of the Provision for Uncollectible Accounts

As discussed in Notes 1 and 2 to the accompanying financial statements, in 2013 the Hospital adopted the provisions of Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, which resulted in a change in the presentation of the provision for uncollectible accounts on the statements of operations and changes in net assets effective October 1, 2012. Our opinion is not modified with respect to this matter.

Ernst & Young LLP

September 29, 2014

The Milford Hospital, Incorporated

Balance Sheets

	September 30 2013	September 30 2012
Assets		
Current assets:		
Cash and cash equivalents	**$ 1,665,016**	$ 404,540
Short-term investments	**110,612**	225,160
Patient accounts receivable, less allowance for uncollectible accounts of approximately $4,094,000 and $4,369,000 in 2013 and 2012, respectively	**9,618,035**	12,293,728
Inventories	**887,860**	861,132
Prepaid expenses and other	**1,727,752**	1,443,580
Insured claims receivable	**814,691**	939,962
Total current assets	**14,823,966**	16,168,102
Investments	**3,482,913**	11,311,143
Assets limited as to use	**2,580,001**	2,681,166
Property, plant, and equipment:		
Land and improvements	**1,434,340**	1,427,341
Building and improvements	**15,228,138**	38,197,439
Equipment	**33,530,177**	32,734,508
	50,192,655	72,359,288
Less accumulated depreciation	**(28,032,185)**	(48,777,136)
	22,160,470	23,582,152
Beneficial interest in Milford Hospital Foundation, Inc.	**894,273**	789,204
Due from affiliates	**348,164**	654,070
Insured claims receivable, net of current portion	**4,086,302**	3,038,843
	5,328,739	4,482,117
Total assets	**$ 48,376,089**	$ 58,224,680

	September 30	
	2013	**2012**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 5,318,753**	$ 4,350,123
Accrued employee compensation	**6,870,249**	6,702,468
Other accrued liabilities	**1,871,366**	2,359,227
Due to affiliates	**20,705**	11,500
Due to third-party reimbursement agencies	**1,691,606**	895,803
Current portion of note payable to bank	**–**	935,367
Insured claims liabilities	**814,691**	939,962
Total current liabilities	**16,587,370**	16,194,450
Insured claims liabilities, net of current portion	**4,086,302**	3,038,843
Accrued pension and other liabilities	**19,096,320**	31,720,924
Total liabilities	**39,769,992**	50,954,217
Net assets:		
Unrestricted	**7,157,824**	5,927,259
Temporarily restricted	**774,510**	669,441
Permanently restricted	**673,763**	673,763
Total net assets	**8,606,097**	7,270,463
Total liabilities and net assets	**$ 48,376,089**	$ 58,224,680

See accompanying notes.

The Milford Hospital, Incorporated

Statements of Operations and Changes in Net Assets

	Year Ended September 30 2013	2012
Operating revenues:		
Net revenues from services to patients (net of contractual allowances and discounts)	**$ 76,359,796**	$ 82,088,250
Provision for uncollectible accounts	**(6,456,481)**	(7,028,914)
Net revenues from services to patients, less provision for uncollectible accounts	**69,903,315**	75,059,336
Other operating revenues	**1,449,445**	2,505,143
	71,352,760	77,564,479
Operating expenses:		
Salaries and wages	**37,819,070**	37,965,219
Employee benefits	**12,180,524**	14,538,699
Supplies and other	**25,901,739**	25,890,496
Depreciation (including impairment loss of approximately $1.5 million on long lived assets)	**4,180,977**	2,796,910
Interest	**34,936**	102,151
	80,117,246	81,293,475
Operating loss	**(8,764,486)**	(3,728,996)
Nonoperating income:		
Investment income, net	**625,298**	1,939,764
Deficiency of revenues over expenses before change in unrealized gains and losses on investments	**(8,139,188)**	(1,789,232)
Change in unrealized gains and losses on investments	**(736,830)**	3,465
Deficiency of revenues over expenses	**(8,876,018)**	(1,785,767)

Continued on next page.

The Milford Hospital, Incorporated

Statements of Operations and Changes in Net Assets (continued)

	Year Ended September 30	
	2013	**2012**
Unrestricted net assets:		
Deficiency of revenues over expenses (continued)	**$ (8,876,018)**	$ (1,785,767)
Net assets released from restrictions for capital	**–**	56,089
Net asset transfers to Milford Health and Medical, Inc.	**(2,203,402)**	(711,414)
Change in net assets related to pension plan liability to be recognized in future periods	**12,309,985**	(11,309,559)
Pension curtailment gain	**–**	5,482,615
Increase (decrease) in unrestricted net assets	**1,230,565**	(8,268,036)
Temporarily restricted net assets:		
Net assets released from restrictions for capital	**–**	(56,089)
Investment income, net	**–**	56,089
Change in beneficial interest of Milford Hospital Foundation, Inc.	**105,069**	43,280
Increase in temporarily restricted net assets	**105,069**	43,280
Increase (decrease) in net assets	**1,335,634**	(8,224,756)
Net assets at beginning of year	**7,270,463**	15,495,219
Net assets at end of year	**$ 8,606,097**	$ 7,270,463

See accompanying notes.

The Milford Hospital, Incorporated

Statements of Cash Flows

	Year Ended September 30 2013	2012
Operating activities		
Change in net assets	**$ 1,335,634**	$ (8,224,756)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Provision for uncollectible accounts	**6,456,481**	7,028,914
Depreciation (including impairment loss of $1.5 million on long-lived assets)	**4,180,977**	2,796,910
Change in unrealized gains and losses on investments	**736,830**	(3,465)
Change in net assets related to pension plan liability to be recognized in future periods	**(12,309,985)**	11,309,559
Pension curtailment gain	**–**	(5,482,615)
Net asset transfers to Milford Health and Medical, Inc.	**2,203,402**	711,414
Change in beneficial interest in Milford Hospital Foundation, Inc.	**(105,069)**	(43,280)
Changes in assets and liabilities:		
Patient accounts receivable	**(3,780,788)**	(6,700,301)
Due from affiliates	**305,906**	22,098
Inventories	**(26,728)**	(86,488)
Prepaid expenses and other	**(284,172)**	23,810
Investments classified as trading	**7,091,400**	8,268,075
Accounts payable	**968,630**	316,811
Accrued employee compensation	**167,781**	394,415
Other accrued liabilities	**(487,861)**	(500,495)
Due to affiliates, net	**9,205**	11,500
Due to third-party reimbursement agencies	**795,803**	(1,128,409)
Accrued pension and other liabilities	**(314,619)**	(6,077,807)
Net cash provided by operating activities	**6,942,827**	2,635,890
Investing activities		
Net purchases of property, plant, and equipment	**(2,759,295)**	(1,642,741)
Net sales (purchases) of short-term investments	**114,548**	(855)
Decrease in assets limited as to use	**101,165**	123,115
Net cash used in investing activities	**(2,543,582)**	(1,520,481)

The Milford Hospital, Incorporated

Statements of Cash Flows (continued)

	Year Ended September 30	
	2013	**2012**
Financing activities		
Payments made on note payable to bank	**$ (935,367)**	$ (955,684)
Net asset transfers to Milford Health and Medical, Inc.	**(2,203,402)**	(711,414)
Net cash used in financing activities	**(3,138,769)**	(1,667,098)
Increase (decrease) in cash and cash equivalents	**1,280,476**	(551,689)
Cash and cash equivalents at beginning of year	**404,540**	956,229
Cash and cash equivalents at end of year	**$ 1,665,016**	$ 404,540

See accompanying notes.

1. Organization and Accounting Policies

Organization

The Milford Hospital, Incorporated (the Hospital), a voluntary tax-exempt acute care hospital incorporated under the general statutes of the state of Connecticut, is a subsidiary of Milford Health and Medical, Inc. (the Parent). The Board of Directors (the Board) of the Hospital, appointed by the Parent, controls the operations of the Hospital. Also, the Milford Hospital Foundation, Inc. is a subsidiary of the Parent, and functions as the fund-raising affiliate for the Hospital.

Financial Transaction and Liquidity

For the years ended September 30, 2013 and 2012, the Hospital had operating losses of approximately $8.8 million and $3.7 million, respectively. The fiscal year 2013 operating loss was partially due to an impairment loss recorded on long-lived assets of $1.5 million. The Hospital's continued existence is dependent upon future operations in which cash revenue exceeds expenses to provide for the maintenance of adequate working capital. Management's plans for dealing with the historical and ongoing effects of recent declining operating results are focused on cost reduction, revenue enhancement, and shared or integrated services with other health care providers.

During September 2014, the Parent entered into a Master Agreement with another health care provider to provide a framework for implementing programs in a manner that is consistent with the charitable mission of each organization and the communities it serves. Under the terms of the agreement the health care provider will utilize beds at the Hospital under a lease arrangement to provide inpatient rehabilitation services to its patients and, will furnish an $8.0 million term loan to the Hospital in order to provide it with liquidity (described in Note 9). Management has determined that the liquidity from the term loan will provide it with the required funding to meet its obligations as they become due and allow the Hospital to continue as a going concern.

In addition to the Master Agreement, the Hospital entered into an Inpatient Rehabilitation Unit (IRU) Lease and an IRU Services Agreement. The details of those agreements are as follows:

- *IRU Lease Agreement:* The term of the IRU Lease Agreement is five years during which time the Hospital will lease certain beds to the health care provider to be used to provide inpatient rehabilitation services to patients of the health care provider. The lease provides the tenant with two five-year renewal options at the end of each term.

1. Organization and Accounting Policies (continued)

- *IRU Services Agreement:* The term of the IRU Services Agreement is five years during which time the health care provider will purchase certain clinical services related to those rehabilitation patients at the Hospital from the Hospital and certain affiliated physicians. The service agreement provides the Hospital with two five-year renewal options at the end of each term.

The Master Agreement requires the Parent to comply with certain financial covenants regarding levels of cash available for operations. If the Parent fails to meet such covenants they are required to provide the health care provider with an action plan related to maintaining certain levels of cash available for operations. If the Parent falls below 20 days cash on hand the health care provider may terminate the agreements in which case the term loan will be due immediately.

Estimates and Assumptions

The preparation of the 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 such as estimated uncollectible accounts for patient accounts receivable, insurance claims liabilities and receivables, estimated impairment of long-lived assets and estimated receivables from and payables to third-party reimbursement agencies, and disclosure of contingent assets and contingent liabilities at the date of the financial statements. The allowance for uncollectible accounts, impairment of long-lived assets, insurance claims liabilities and receivables, and the estimated receivables from and payables to third-party reimbursement agencies, among other accounts, require significant use of estimates. Estimates also affect the reported amounts of revenues and expenses during the reported 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. Organization and Accounting Policies (continued)

Cash and Cash Equivalents and Short-Term Investments

The Hospital considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Short-term investments consist of bank certificates of deposit. Cash and cash equivalents are maintained with domestic financial institutions with deposits that exceed federally insured limits and, therefore, bear a risk of loss.

Inventories

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

Fair Value of Financial Instruments

The carrying value of financial instruments in the accompanying balance sheets as of September 30, 2013 and 2012, approximates fair value based on current market conditions. The fair value of each financial instrument is disclosed in the respective notes and in Note 4.

Investments

The Hospital's investment portfolio is classified as trading, with changes in unrealized gains and losses included in the deficiency of revenues over expenses. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value at the balance sheet date. Assets temporarily restricted (by donor) are recorded at fair value at the date of donation, which is then considered cost.

Alternative investments (not readily marketable assets) are stated in the accompanying balance sheets based upon net asset values 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. Financial information used by the Hospital to evaluate its alternative investments is prepared by the investment manager or general partner and includes fair value valuations that may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. Generally, fair value reflects net contributions to the investee and an ownership share of realized and unrealized investment income and expenses. The investments may indirectly expose the Hospital to

1. Organization and Accounting Policies (continued)

securities lending, short sales of securities, and trading in futures and forwards contracts, options, swap contracts, and other derivative products. While these financial instruments may contain varying degrees of risk, the Hospital's risk with respect to such transactions is limited to its capital balance in each investment. The financial statements of the investees are audited annually by independent auditors.

There is uncertainty in determining values of alternative investments arising from factors such as lack of active markets (primary and secondary), lack of transparency into underlying holdings, and time lags associated with reporting by the investee companies. As a result, there is at least a reasonable possibility that estimates will change.

Investment income, including realized and changes in unrealized gains and losses on investments, interest, and dividends, 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. The financial statements of the investees are audited annually by independent auditors.

The alternative investments include certain liquidity restrictions that may require 90 days advance notice for redemptions, and there are remaining commitments to the alternative investment funds of approximately $266,000 as of September 30, 2013.

Assets Limited as to Use

Assets limited as to use primarily consist of interest-bearing deposits in banks which have been set aside by the Board and restricted by donors for future capital improvements or purchases of equipment. Except for the assets restricted by donors, the Board retains control of funds it has set aside and may, at its discretion, subsequently use these funds for other purposes.

Patient Accounts Receivable

Patient accounts receivable result from the health care services provided by the Hospital. Additions to the allowance for uncollectible accounts result from the provision for 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 upon management's assessment of historical and expected net collections, business and economic conditions, trends

1. Organization and Accounting Policies (continued)

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 consists 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, before allowances for uncollectible accounts, include 39% and 47% for Medicare, and 7% and 6% for Medicaid, for the years ended September 30, 2013 and 2012, respectively.

Property, Plant, and Equipment

Property, plant, and equipment is stated on the basis of cost. Depreciation of property, plant, and equipment is provided using the straight-line method over their estimated useful lives of the related assets as follows:

Building and improvements	5 – 50 years
Equipment	3 – 25 years

Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If long-lived assets are deemed to be impaired, the impairment loss to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value. As a result of declining operating results, the Hospital performed an evaluation of long-lived assets at September 30, 2013. In performing the test, the Hospital determined that the total of the expected future undiscounted cash flows directly related to its enterprise-wide asset group was less than the carrying value of the asset group; therefore, an impairment loss was required to be recorded. The impairment loss of $1.5 million represents the difference between the fair value of the asset group and its related carrying value and is included within asset impairment loss in the consolidated statement of operations for the year ended September 30, 2013. The loss has been allocated to various categories of fixed assets. Fair value of the asset group that was deemed to be impaired, principally fixed assets, was primarily based on a combination of the cost and sales comparison approaches. The cost approach provides an indication of the current cost to reproduce or replace

1. Organization and Accounting Policies (continued)

an asset by an estimate of accrued depreciation. The sales comparison approach is based on the principle of whether a property is replaceable in the market. Because of uncertainty in the current market, it is reasonably possible that the estimate of the fair value of the asset group may change in the near term.

Restricted Net Assets

Temporarily restricted net assets are those where use by the Hospital has been limited by donors to a specific time frame or purpose. All of the Hospital's temporarily restricted net assets are restricted for capital expenditures. Permanently restricted net assets are amounts to be maintained in perpetuity, the income of which can be used for capital expenditures.

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 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 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 included in nonoperating income in the accompanying statements of operations and changes in net assets.

Deficiency of Revenues Over Expenses

The accompanying statements of operations and changes in net assets include the deficiency of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from the deficiency of revenues over expenses include permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets, including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets, change in net assets related to pension plan liability to be recognized in future periods, and the pension curtailment gain.

1. Organization and Accounting Policies (continued)

Nonoperating Income

Activities, other than in connection with providing health care services, are considered to be nonoperating. Nonoperating income primarily consists of income on invested funds and unrestricted gifts.

Beneficial Interest in Milford Hospital Foundation, Inc.

The interest in Milford Hospital Foundation, Inc. represents the Hospital's beneficial interest in net assets of The Milford Hospital Foundation, Inc. This investment is accounted for in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-20, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.*

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 and is exempt from the state of Connecticut and local income taxes. The Hospital has a net operating loss carryforward from unrelated business activities of approximately \$6,048,000. A deferred tax asset for these losses of approximately \$2,419,200 is offset by a corresponding valuation allowance of the same amount. Operating loss carryforwards will begin to expire in six years.

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 September 29, 2014, which is the date the financial statements were available to be issued.

Effective January 9, 2014, the Hospital received approval for grant funding in the amount of \$2,000,000 from the State of Connecticut Department of Public Health to purchase medical and computer equipment to meet the clinical needs of its patients. Effective August 11, 2014, the Hospital executed a promissory note for \$1,000,000 with Seaside Indemnity Alliance Company,

1. Organization and Accounting Policies (continued)

Ltd (SIAC), a wholly owned subsidiary of the Parent. This note is payable on demand to SIAC and bears interest at a rate of U.S. prime plus fifty basis points. No other events occurred that require disclosure in or adjustment to the financial statements except for the transaction described in the financial transaction and liquidity section of Note 1.

New Accounting Standards

In July 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The provisions of ASU No. 2011-07 require certain health care entities that recognize significant amounts of patient service revenue at the time the services are rendered without assessing the patient’s ability to pay to present the provision for bad debts related to patient service revenue as a deduction from patient service revenue in the statement of operations and changes in net assets rather than as an operating expense. Additional disclosures relating to sources of patient service revenue and the allowance for uncollectible accounts are also required. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011, with early adoption permitted. The Hospital adopted those provisions as of and for the year ended September 30, 2013, and retrospectively applied the presentation requirements to all periods presented. There was no material impact to the Hospital’s financial statements other than the required changes in presentation. See Note 2 for additional disclosures required by ASU No. 2011-07.

Reclassifications

Certain reclassifications have been made to the 2012 balances previously reported to conform to the current year presentation. These reclassifications relate to the adoption of ASU No. 2011-07 and approximately $2,363,000 previously included in supplies and other within operating expenses to a component of net revenue from services to patients. In addition, $1,000,000 has been reclassified from investments to assets limited as to use.

2. Revenues From Services to Patients and Charity Care

The following table summarizes net revenues from services to patients:

	Year Ended September 30	
	2013	**2012**
Gross revenues from services to patients	**$ 194,913,879**	$ 189,422,163
Deductions:		
Allowances	**117,910,482**	107,141,380
Charity care	**643,601**	192,533
	118,554,083	107,333,913
Net revenues from services to patients (net of contractual allowances and discounts)	**76,359,796**	82,088,250
Provision for uncollectible accounts	**(6,456,481)**	(7,028,914)
Net revenues from services to patients less provision for uncollectible accounts	**$ 69,903,315**	$ 75,059,336

Patient revenues from services to patients for the years ended September 30, 2013 and 2012, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the period from these major payor sources based on primary insurance designation, are as follows:

	Year Ended September 30	
	2013	**2012**
Third-party payors	**$ 70,738,217**	$ 76,276,725
Self-pay	**5,621,579**	5,811,525
Total all payors	**$ 76,359,796**	$ 82,088,250

2. Revenues From Services to Patients and Charity Care (continued)

Deductibles and copayments under third-party payment programs within the third-party payor amount above are the patient's responsibility and the Hospital considers these amounts in its determination of the provision for bad debts based on collection experience.

Accounts receivable are also reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and the provision for uncollectible accounts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts.

For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for uncollectible accounts, if necessary (for example, for payors who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients which includes both patients without insurance and patients with deductible and copayment balances 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 that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between discounted rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

The Hospital allowance for uncollectible accounts totaled approximately $4,094,000 and $4,369,000 at September 30, 2013 and 2012, respectively. The allowance for uncollectible accounts for self-pay patients was approximately 91.5% and 90.8% of self-pay accounts receivable as of September 30, 2013 and 2012, respectively. Overall, the total of self-pay discounts and write-offs has not changed significantly for the year ended September 30, 2013. The Hospital has not experienced significant changes in write-off trends.

During fiscal years 2013 and 2012, the Hospital's net revenues from services to patients were 37.0% and 40.7% from Medicare, 7.0% and 4.4% from Medicaid, and 17.9% and 17.3% from Blue Cross (governmental payors include managed Medicare and Medicaid business), respectively. Laws and regulations governing the Medicare and Medicaid programs are complex

2. Revenues From Services to Patients and Charity Care (continued)

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.

Patient accounts receivable and revenues are recorded when patient services are performed. The Hospital has agreements with certain third-party payors, including health maintenance organizations that provide for payments to the Hospital at amounts different from the Hospital's established billing rates. These differences are accounted for as allowances. Under these agreements, the Hospital receives reimbursement based on a number of different arrangements, including fee-for-service payments.

Net revenues from services to patients 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. Revenue under third-party payor agreements is subject to audit and retroactive adjustments. 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. Retroactive adjustments related to settlements with third-party payors decreased net revenues from services to patients by approximately $642,000 for the year ended September 30, 2013, and increased net revenues from services to patients by approximately $2,101,000 for the year ended September 30, 2012. In prior years, the Hospital was a party to a Medicare appeal claim challenging the calculation of the rural floor budget neutrality adjustment. In fiscal 2012, the appeal was settled and the Hospital received a payment of approximately $869,000, which was included in retroactive settlement adjustments for the year ended September 30, 2012.

2. Revenues From Services to Patients and Charity Care (continued)

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 a patient's income level. These charges are not included in net revenues from services to patients for financial reporting purposes.

The estimated cost of charity care provided was $294,641 and $92,166 for the 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. Investments

Investments are comprised of the following at September 30:

	2013	2012
Cash and cash equivalents	**$ 413,309**	$ 1,283,664
Government bonds	–	2,015,518
Corporate bonds	–	1,541,644
Other fixed income	–	24,924
Equities	**1,536,712**	4,440,235
Commodities	–	702,604
Alternative investments	**1,532,892**	1,283,286
Accrued interest	–	19,268
	$ 3,482,913	$ 11,311,143

3. Investments (continued)

Assets limited as to use are comprised of the following at September 30:

	2013	2012
Cash and cash equivalents	**$ 1,613,777**	$ 1,694,939
Government bonds	**410,285**	379,175
Corporate bonds	**132,382**	179,947
Other fixed income securities	**306,642**	327,947
Equities	**114,965**	96,355
Accrued interest	**1,950**	2,803
	$ 2,580,001	$ 2,681,166

The composition of assets limited as to use at September 30 is as follows:

	2013	2012
Internally designated	**$ 1,855,375**	$ 1,939,766
Temporarily restricted for capital purposes	**170,626**	187,400
Permanently restricted	**554,000**	554,000
	$ 2,580,001	$ 2,681,166

3. Investments (continued)

The components of investment earnings, included in nonoperating income, include the following for the years ended September 30:

	2013	2012
Interest income	**$ 17,860**	$ 28,607
Dividend income	**238,670**	285,887
Realized gains and losses	**631,946**	1,890,211
Other	**(263,178)**	(264,941)
Investment income, net	**$ 625,298**	$ 1,939,764
Change in unrealized gains and losses on investments	**(736,830)**	3,465
Total return on investments	**$ (111,532)**	$ 1,943,229

4. Fair Value of Financial Instruments

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

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

Level 2: Observable inputs that 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.

4. Fair Value of Financial Instruments (continued)

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 utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers nonperformance risk in its assessment of fair value.

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

	September 30, 2013			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 1,665,016	$ –	$ –	$ 1,665,016
Short-term investments:				
Cash and cash equivalents	110,612	–	–	110,612
Investments:				
Cash and cash equivalents	413,309	–	–	413,309
Equities:				
International	632,081	–	–	632,081
Mid cap	222,732	–	–	222,732
Large cap	679,359	–	–	679,359
Emerging markets	2,540	–	–	2,540
Assets limited as to use:				
Cash and cash equivalents	1,613,777	–	–	1,613,777
Fixed income:				
Government bonds	–	410,285	–	410,285
Corporate bonds	–	132,382	–	132,382
Other	–	306,642	–	306,642
Equities:				
Small cap	3,927	–	–	3,927
Mid cap	3,908	–	–	3,908
Large cap	101,690	–	–	101,690
International	5,440	–	–	5,440

4. Fair Value of Financial Instruments (continued)

	September 30, 2012			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 404,540	$ –	$ –	$ 404,540
Short-term investments:				
Cash and cash equivalents	225,160	–	–	225,160
Investments:				
Cash and cash equivalents	1,283,664	–	–	1,283,664
Fixed income:				
Government bonds	–	2,015,518	–	2,015,518
Corporate bonds	–	1,541,644	–	1,541,644
Other	–	24,924	–	24,924
Equities:				
International	1,317,713	–	–	1,317,713
Small cap	24,893	–	–	24,893
Mid cap	637,840	–	–	637,840
Large cap	1,955,888	–	–	1,955,888
Emerging markets	503,901	–	–	503,901
Commodities	702,604	–	–	702,604
Assets limited as to use:				
Cash and cash equivalents	1,694,939	–	–	1,694,939
Fixed income:				
Government bonds	–	379,175	–	379,175
Corporate bonds	–	179,947	–	179,947
Other	–	327,947	–	327,947
Equities:				
International	4,350	–	–	4,350
Small cap	3,038	–	–	3,038
Mid cap	3,142	–	–	3,142
Large cap	85,825	–	–	85,825

The amounts reported in the tables above do not include alternative investments totaling $1,532,892 and $1,283,286 for the years ended September 30, 2013 and 2012, respectively, that are accounted for under the equity method of accounting.

4. Fair Value of Financial Instruments (continued)

Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is based upon 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.

5. Debt

The Hospital had a mortgage note arrangement with a bank secured by hospital property. The Hospital paid principal and interest at a fixed rate of 6.86% over a ten-year term. At September 30, 2012, the Hospital had an unpaid principal balance of $935,367. The mortgage note had a maturity date of August 15, 2013. Interest paid during fiscal years 2013 and 2012 amounted to $30,869 and $97,317, respectively. As of September 30, 2012, the carrying value of the mortgage note approximated fair value.

6. Pension Plan

The Hospital has a defined benefit pension plan (the Plan) covering substantially all of its employees. Plan benefits are based on years of service and the employee's compensation. Plan participants will vest in their benefits on a percentage basis with years of service.

Effective August 26, 2009, the Hospital's executive committee of the Board of Directors adopted a resolution to freeze the Plan for non-union employees effective December 31, 2009. Effective January 24, 2012, the Hospital's executive committee of the Board of Directors adopted a resolution to freeze the Plan for nursing union employees effective January 31, 2012, which resulted in a pension curtailment gain of $5,482,615.

The Hospital recognizes the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligation) of the Plan in its balance sheet.

Net unrecognized actuarial losses at the reporting date will be subsequently recognized in the future as net periodic pension cost pursuant to the Hospital's accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods will be recognized as a component of unrestricted net assets.

6. Pension Plan (continued)

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

	2013	2012
Unrecognized actuarial loss	**$ (15,406,302)**	$ (27,716,287)
	$ (15,406,302)	$ (27,716,287)

The following table presents a reconciliation of the beginning and ending balances of the Plan's projected benefit obligation and the fair value of plan assets, as well as the funded status of the Plan and accrued pension cost included in the financial statements:

	September 30	
	2013	**2012**
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 93,981,617**	$ 82,488,161
Service cost	**333,194**	988,966
Interest cost	**3,465,833**	3,644,948
Benefits paid	**(3,690,998)**	(2,974,691)
Expenses paid	**(535,754)**	(570,708)
Curtailment gain	**–**	(5,482,615)
Actuarial (gains) losses	**(11,847,293)**	15,887,556
Benefit obligation at end of year	**81,706,599**	93,981,617
Change in plan assets		
Fair value of plan assets at beginning of year	**64,873,614**	52,878,221
Contributions	**625,000**	7,052,981
Actual return on plan assets	**4,597,953**	8,487,811
Benefits paid	**(3,690,998)**	(2,974,691)
Expenses paid	**(535,754)**	(570,708)
Fair value of plan assets at end of year	**65,869,815**	64,873,614
Funded status of the Plan	**$ (15,836,784)**	$ (29,108,003)

6. Pension Plan (continued)

	September 30	
	2013	**2012**
Components of net periodic pension cost		
Service cost	**$ 333,194**	$ 988,966
Interest cost	**3,465,833**	3,644,948
Expected return on plan assets	**(4,805,664)**	(4,454,673)
Curtailment loss	**–**	222,808
Net amortization and deferral	**670,403**	322,051
Net periodic pension (credit) cost	**$ (336,234)**	$ 724,100

The weighted-average assumptions used to develop net periodic benefit cost, and the projected benefit obligation as of September 30 are as follows:

	2013	**2012**
Discount rate used for net periodic pension cost	**3.73%**	4.75%
Discount rate used for projected benefit obligation	**4.65**	3.73
Expected long-term rate of return on plan assets	**7.50**	8.00
Rate of compensation increase	**N/A**	3.00

The accumulated benefit obligation at September 30, 2013 and 2012, was $81,706,599 and $93,981,617, respectively.

Plan Assets

To develop the expected long-term rate of return on plan assets assumption, the Hospital considers the historical return and the future expectations for return for each asset class, as well as target allocation of the plan asset portfolio. The Plan's investment objectives are to achieve long-term growth in excess of long-term inflation, and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets over a long-term time horizon. In order to minimize the risk, the Plan aims to minimize the variability in yearly returns. The Plan also aims to diversify its holdings among sectors, industries, and companies. No more than 10% of the Plan's portfolio, excluding U.S. government securities and cash, may be held in an individual company's stocks or bonds, and no more than 20% in a single industry.

6. Pension Plan (continued)

The Hospital's pension plan weighted-average allocations at September 30, 2013 and 2012, by asset category, are as follows:

	2013	**2012**
Asset Category		
Cash and money market funds	**9.4%**	11.6%
Government bonds	**12.9**	13.7
Corporate bonds	**8.2**	7.9
Equities	**64.1**	62.2
Alternative investments	**5.4**	4.6
Total	**100.0%**	100.0%

The target allocation for the Plan's assets is 65% equity securities, 25% fixed income securities, and 10% other investments.

Financial assets carried at fair value included in the Plan are classified in the tables below in one of the three categories described above:

	September 30, 2013			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 6,212,552	$ –	$ –	$ 6,212,552
Fixed income:				
Government bonds	–	8,523,744	–	8,523,744
Corporate bonds	–	5,394,936	–	5,394,936
Equities:				
International	13,479,371	–	–	13,479,371
Mid cap	3,092,328	–	–	3,092,328
Large cap	25,581,878	–	–	25,581,878
Alternative investments	–	–	3,585,006	3,585,006
	$ 48,366,129	$ 13,918,680	$ 3,585,006	$ 65,869,815

6. Pension Plan (continued)

	September 30, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 7,504,707	$ –	$ –	$ 7,504,707
Fixed income:				
Government bonds	–	8,858,044	–	8,858,044
Corporate bonds	–	5,117,442	–	5,117,442
Equities:				
International	13,610,566	–	–	13,610,566
Mid cap	2,520,875	–	–	2,520,875
Large cap	24,274,555	–	–	24,274,555
Alternative investments	–	–	2,987,425	2,987,425
	$ 47,910,703	$ 13,975,486	$ 2,987,425	$ 64,873,614

The changes in investments classified as Level 3 are as follows for the years ended September 30:

	2013	2012
Beginning balance for the year	**$ 2,987,425**	$ 2,127,822
Purchases	**500,000**	687,500
Net change in unrealized appreciation	**97,581**	172,103
Ending balance for the year	**$ 3,585,006**	$ 2,987,425

Assets invested in the defined benefit cash balance plan are carried at fair value based upon, as a practical expedient, net asset values derived from the application of the equity method of accounting. Debt securities and equity securities with readily determinable values are classified as Level 1 as determined based on independent published sources. Level 2 assets are valued 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. Assets that are valued using

6. Pension Plan (continued)

significant unobservable inputs, such as extrapolated data, proprietary models, or indicative quotes that cannot be corroborated with market data are classified in Level 3 within the fair value hierarchy.

Level 3 assets are valued based on the Hospital's ownership interest in the net asset value (NAV) of the fund as discussed above. As the NAV reported by each fund is used as a practical expedient to estimate the fair value of the Hospital's interest therein, its classification as Level 3 is based on the Hospital's ability to redeem its interest at or near the measurement date. The Hospital routinely monitors and assesses methodologies and assumptions used in valuing these interests.

Contributions

The Hospital does not expect to contribute to the Plan in 2014.

Estimated Future Benefit Payments

Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Fiscal years:	
2014	$ 3,498,222
2015	3,662,934
2016	3,858,008
2017	4,010,609
2018	4,235,307
Years 2019 – 2023	24,791,691

7. Transactions with Affiliates

Amounts expected to be collected from affiliated entities are as follows:

	September 30	
	2013	**2012**
Milford Medical Lab, Inc.	**$ 261,208**	$ 221,205
Milford Health and Medical, Inc.	**–**	364,864
Home Care Plus, Inc.	**37,900**	34,777
Other affiliated entities	**49,056**	33,224
	$ 348,164	$ 654,070

Amounts due from Milford Medical Lab, Inc. relate to lab and related services provided by the Hospital on behalf of Milford Medical Lab, Inc. The Hospital charged Milford Medical Lab, Inc. $593,908 and $692,504 in 2013 and 2012, respectively, for those services. Amounts due from Milford Health and Medical, Inc.; Home Care Plus, Inc.; and other affiliated entities are the result of allocating joint general and administrative costs incurred by the Hospital. The amounts allocated to affiliates during the years ended September 30, 2013 and 2012, were $268,371 and $274,088, respectively.

8. Medical Malpractice Insurance

Effective October 1, 2004, the Hospital became insured by the Parent through Healthcare Alliance Insurance Company, Ltd. (HAIC). HAIC is a multi-provider captive insurance company domiciled in the Cayman Islands. The Parent was a one-third owner of the captive with two other local hospitals that each hold one-third ownership. The Hospital's insurance coverage was $1,500,000 per occurrence and $3,000,000 in the aggregate. The Hospital had an excess layer of indemnity coverage of $25,000,000 per occurrence and $25,000,000 in the aggregate.

Effective July 1, 2013, the Parent sold its equity interest in HAIC and the Hospital became insured by SIAC. SIAC was incorporated on May 10, 2013, under the laws of the Cayman Islands and is a wholly owned subsidiary of the Parent. SIAC's activities are the direct insurance of the Hospital's professional and comprehensive general liability risks together with the physician professional liability risks of certain of the Hospital's affiliated physicians.

8. Medical Malpractice Insurance (continued)

The Hospital's claims-made insurance coverage through SIAC, beginning July 1, 2013, is $26,500,000 per claim with a policy aggregate of $28,750,000. SIAC purchases reinsurance coverage which is $25,000,000 per claim and $25,000,000 in the aggregate.

SIAC will assume risks previously insured by HAIC during the period 2004 to 2013 via a loss portfolio transfer. The coverage limits in relation to these prior periods remain the same.

Management accrues its best estimate of losses as they occur. Accordingly, management has recorded a liability of approximately $761,000 and $596,000 at September 30, 2013 and 2012, respectively, for claims incurred but not reported which is included in accrued pension and other liabilities on the accompanying balance sheets. This liability has been discounted using a 3% discount rate at September 30, 2013 and 2012.

Malpractice claims have been asserted against the Hospital by various claimants. These claims are in various stages of processing, and some may ultimately be brought to trial. There are known incidents that have occurred through September 30, 2013, that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. In management's opinion, the outcome of these matters will not have a material effect on the Hospital's financial statements.

9. Commitments and Contingencies

The Hospital is a party to various lawsuits incidental to its business. Management believes that the lawsuits fall within the Hospital's liability insurance, and that they will not have a material adverse effect on the Hospital's financial statements.

As described in Note 1, the Hospital entered into a term loan agreement as part of a transaction with a health care provider. The term loan agreement has a term that coincides with the IRU Lease Agreement in that the loan termination date is the date of termination or expiration of the IRU Lease Agreement. The term of the IRU Lease Agreement is five years and provides the tenant with two five-year renewal options at the end of each term.

The term loan bears interest of 6.5% annually that is payable monthly. The loan is collateralized by certain property owned by a subsidiary of the Parent.

10. Functional Expenses

The Hospital provides inpatient and outpatient general health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	Year Ended September 30	
	2013	2012
Healthcare services	**$ 70,166,284**	$ 71,267,495
General and administrative	**9,950,962**	10,025,980
	$ 80,117,246	$ 81,293,475

11. Other Operating Revenues

Other operating revenues consist of the following for the years ended September 30:

	2013	**2012**
Electronic health records incentive payments	**$ 977,058**	$ 2,003,647
Cafeteria	**220,717**	237,396
Pharmacy	**178,878**	198,790
Other	**72,792**	65,310
	$ 1,449,445	$ 2,505,143

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

11. Other Operating Revenues (continued)

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

The Hospital uses a grant accounting model to recognize revenue for the Medicare and Medicaid EHR incentive payments. Under this accounting policy, EHR incentive payment revenue is recognized when the Hospital is reasonably assured that the EHR meaningful use criteria for the required period of time were met and that the grant revenue will be received. EHR incentive payment revenue from Medicare and Medicaid for the years ended September 30, 2013 and 2012, was $977,058 and $2,003,647, respectively, and is included in other operating revenues. Income from incentive payments is subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated. Included in due to third-party reimbursement agencies is a retrospective adjustment of $378,555 for this purpose, as of September 30, 2013. Additionally, the Hospital's attestation of compliance with the meaningful use criteria is subject to audit.

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