



SILVER HILL HOSPITAL, INC.

Financial Statements

February 28, 2014 and 2013

(With Independent Auditors' Report Thereon)

SILVER HILL HOSPITAL, INC.

Table of Contents

	Page(s)
Independent Auditors' Report	1
Financial Statements:	
Statements of Financial Position	2
Statements of Operations	3
Statements of Changes in Net Assets	4
Statements of Cash Flows	5
Notes to Financial Statements	6-19



KPMG LLP
345 Park Avenue
New York, NY 10154-0102

Independent Auditors' Report

The Board of Directors
Silver Hill Hospital, Inc.:

We have audited the accompanying financial statements of Silver Hill Hospital, Inc., which comprise the statements of financial position as of February 28, 2014 and 2013, and the related statements of operations, 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 accordance 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 from 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from 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 auditors consider 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 overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Silver Hill Hospital, Inc. as of February 28, 2014 and 2013, and the results of its operations and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

June 25, 2014

SILVER HILL HOSPITAL, INC.

Statements of Financial Position

February 28, 2014 and 2013

Assets	2014	2013
Current assets:		
Cash and cash equivalents	\$ 1,947,205	1,368,392
Investments (note 3)	6,687,905	4,420,962
Patient accounts receivable, net of allowance for doubtful accounts of \$721,651 and \$470,948 (note 2)	3,254,162	3,727,519
Prepaid expenses	1,055,369	813,897
Other current assets, net	136,571	151,819
Insurance claims receivable (note 8)	121,730	850,000
Assets limited or restricted as to use – current liabilities (note 3)	1,959,423	2,323,699
Total current assets	15,162,365	13,656,288
Assets limited or restricted as to use (note 3):		
Temporarily and permanently restricted donations	831,369	824,848
Liquid reserve requirement	1,500,000	1,500,000
Total assets limited or restricted as to use	2,331,369	2,324,848
Other assets, net	92,406	115,671
Insurance claims receivable (note 8)	923,935	195,651
Property and equipment, net (note 4)	32,167,983	29,830,017
Total assets	\$ 50,678,058	46,122,475
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 798,952	880,445
Due to patients and third parties	1,108,687	1,549,984
Accrued salaries, taxes, and other compensation	1,030,575	852,531
Current portion of long-term debt (note 5)	100,276	95,813
Other current liabilities	994,923	876,276
Estimated malpractice liability – current (note 8)	121,730	900,000
Total current liabilities	4,155,143	5,155,049
Line of credit (note 6)	127,680	127,680
Long-term debt, net of current portion (note 5)	4,105,826	4,206,102
Estimated malpractice liabilities (note 8)	1,432,750	569,075
Total liabilities	9,821,399	10,057,906
Net assets:		
Unrestricted	40,025,290	35,239,721
Temporarily restricted (note 11)	618,369	611,848
Permanently restricted (note 11)	213,000	213,000
Total net assets	40,856,659	36,064,569
Commitments and contingencies (notes 5, 6, 7, and 8)		
Total liabilities and net assets	\$ 50,678,058	46,122,475

See accompanying notes to financial statements.

SILVER HILL HOSPITAL, INC.

Statements of Operations

Years ended February 28, 2014 and 2013

	2014	2013
Revenue, gains, and other support:		
Net patient service revenue before provision for bad debts, net (note 2)	\$ 38,122,537	35,007,505
Provision for bad debts, net (note 2)	(511,476)	(196,137)
Net patient service revenue	37,611,061	34,811,368
Contributions	653,251	753,201
Other revenue	363,652	312,358
Net assets released from restriction for use in operations	758,638	760,140
Total revenues, gains, and other support	39,386,602	36,637,067
Expenses (note 10):		
Salaries and related costs	18,182,601	16,898,932
Employee benefits (note 9)	4,665,519	4,266,118
Supplies and services	9,939,905	8,870,001
Depreciation and amortization	1,885,232	1,703,477
Development expense	571,757	575,169
Interest expense	200,698	121,720
Loss on the disposal of property and equipment	—	93,290
Total expenses	35,445,712	32,528,707
Income from operations	3,940,890	4,108,360
Nonoperating gains (losses):		
Investment income, net	174,498	191,476
Realized gains on investments	70,021	489,392
Provision for uncollectible pledges	—	(22,748)
Other gains (losses), net	21,255	(8,839)
Total nonoperating gains (losses), net	265,774	649,281
Excess of revenues, gains, other support and nonoperating gains (losses) over expenses	4,206,664	4,757,641
Other changes in unrestricted net assets:		
Change in net unrealized gains on other than trading securities	573,905	(231,361)
Net assets released from restriction for use in capital projects	5,000	3,500
Increase in unrestricted net assets	\$ 4,785,569	4,529,780

See accompanying notes to financial statements.

SILVER HILL HOSPITAL, INC.

Statements of Changes in Net Assets

Years ended February 28, 2014 and 2013

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net assets at February 29, 2012	\$ 30,709,941	619,469	213,000	31,542,410
Excess of unrestricted revenues, gains, and other support and nonoperating gains (losses) over expenses	4,757,641	—	—	4,757,641
Restricted contributions	—	31,620	—	31,620
Provision for uncollectible pledges	—	(50,000)	—	(50,000)
Special event revenue – gala for scholarships, net of direct donor benefit of \$127,500	—	739,523	—	739,523
Investment income, net of realized gains	—	31,102	—	31,102
Change in net unrealized gains on other than trading securities	(231,361)	3,774	—	(227,587)
Net assets released from restriction for use in operations	—	(760,140)	—	(760,140)
Net assets released from restriction for use in capital projects	3,500	(3,500)	—	—
Changes in net assets	<u>4,529,780</u>	<u>(7,621)</u>	<u>—</u>	<u>4,522,159</u>
Net assets at February 28, 2013	<u>35,239,721</u>	<u>611,848</u>	<u>213,000</u>	<u>36,064,569</u>
Excess of unrestricted revenues, gains, and other support and nonoperating gains (losses) over expenses	4,206,664	—	—	4,206,664
Restricted contributions	—	67,663	—	67,663
Special event revenue – Young Professional Event for scholarships, net of direct donor benefit of \$22,085	—	9,613	—	9,613
Special event revenue – gala for scholarships, net of direct donor benefit of \$130,000	—	686,696	—	686,696
Investment income, net of realized gains	—	16,337	—	16,337
Change in net unrealized gains on other than trading securities	573,905	(10,150)	—	563,755
Net assets released from restriction for use in operations	—	(758,638)	—	(758,638)
Net assets released from restriction for use in capital projects	5,000	(5,000)	—	—
Changes in net assets	<u>4,785,569</u>	<u>6,521</u>	<u>—</u>	<u>4,792,090</u>
Net assets at February 28, 2014	\$ <u>40,025,290</u>	<u>618,369</u>	<u>213,000</u>	<u>40,856,659</u>

See accompanying notes to financial statements.

SILVER HILL HOSPITAL, INC.

Statements of Cash Flows

Years ended February 28, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Change in net assets	\$ 4,792,090	4,522,159
Adjustments to reconcile the change in net assets to net cash provided by operating activities:		
Depreciation and amortization	1,885,232	1,703,477
Provision for bad debts, net	511,476	196,137
Loss on disposal of assets	—	93,290
Provision for uncollectible pledge	—	72,748
Contributions restricted for capital projects	(5,000)	(3,500)
Net unrealized (gains) losses on other than trading securities	(563,755)	227,587
Realized gains on investments	(70,021)	(489,392)
Changes in assets and liabilities:		
Patient accounts receivable	(38,119)	(1,789,951)
Prepaid expenses	(241,472)	(349,900)
Insurance claims receivable	(14)	(724,432)
Other current assets, net	15,248	(25,100)
Other assets	—	472
Accounts payable and accrued expenses	246,573	(58,403)
Due to patients and third parties	(441,297)	913,785
Accrued salaries, taxes, and other compensation	178,044	(194,233)
Other current liabilities	118,647	75,508
Estimated malpractice liabilities	85,405	898,731
Net cash provided by operating activities	<u>6,473,037</u>	<u>5,068,983</u>
Cash flows from investing activities:		
Purchases of property and equipment	(520,433)	(494,807)
Purchase of contiguous properties	—	(5,328,042)
Expenditures for Hospital campus renovations	(4,007,566)	(2,245,188)
Purchases of investments	(4,558,074)	(2,187,481)
Proceeds from sale of investments	2,924,907	6,168,969
Change in assets limited or restricted as to use	357,755	(1,000,594)
Net cash used in investing activities	<u>(5,803,411)</u>	<u>(5,087,143)</u>
Cash flows from financing activities:		
Contributions restricted for capital projects	5,000	3,500
Repayment of line of credit	—	(5,000,000)
Proceeds from mortgages	—	4,320,000
Repayment of mortgages	(95,813)	(18,085)
Deferred financing costs incurred	—	(53,323)
Net cash used in financing activities	<u>(90,813)</u>	<u>(747,908)</u>
Increase (decrease) in cash and cash equivalents	578,813	(766,068)
Cash and cash equivalents, beginning of year	1,368,392	2,134,460
Cash and cash equivalents, end of year	<u>\$ 1,947,205</u>	<u>1,368,392</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 102,608	128,348
Increase in accounts payable and accrued expense for Hospital campus renovation expenditures	—	203,691

See accompanying notes to financial statements.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

(1) Nature of Activities and Significant Accounting Policies

Nature of Activities

Silver Hill Hospital, Inc. (the Hospital) is a not-for-profit private psychiatric hospital, which provides medical attention to patients with psychiatric or substance abuse diagnosis through inpatient, residential, and outpatient programs. Silver Hill was incorporated in the state of Connecticut in 1934.

A summary of the Hospital's significant accounting policies is as follows:

(a) *Basis of Accounting*

The Hospital's financial statements have been prepared on the accrual basis of accounting.

(b) *Cash and Cash Equivalents*

The Hospital considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

(c) *Concentration of Credit Risk*

The Hospital has cash balances in financial institutions that exceed federal depository insurance limits of \$250,000.

(d) *Patient Accounts Receivable*

The collection of receivables from third-party payors and patients is the Hospital's primary source of cash for operations and is critical to its operating performance. The primary collection risks relate to uninsured patient accounts and patient accounts for which the primary insurance payor has paid, but patient responsibility amounts (deductibles and co-payments) remain outstanding. Patient receivables, where a third-party payor is responsible for paying the amount, are carried at a net amount determined by the original charge for the service provided, less an estimate made for contractual adjustments to third-party payors. Patient receivables due directly from the patients are carried at the original charge for the service provided less amounts covered by third-party payors and less an estimated allowance for uncollectible receivables. Management estimates this allowance based on the aging of its accounts receivable and its historical collection experience for each payor type. Recoveries of receivables previously written off are recorded as a reduction of the provision for uncollectible accounts when received. The past-due status of receivables is determined on a case-by-case basis depending on the responsible payor. Interest is generally not charged on past-due accounts.

(e) *Pledges Receivable*

Pledges, less an allowance for uncollectible amounts (if warranted), are recorded as pledges receivable in the year the pledge is made.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

(f) *Assets Limited or Restricted as to Use*

Assets limited or restricted as to use include assets set aside for current liabilities, including the Hospital 401(k) contribution to employees and deposits due to patients and third parties, assets restricted based on donors' intents, and liquid assets restricted by the line-of-credit and mortgage agreements.

(g) *Investments*

The Hospital accounts for its investments in accordance with current accounting standards for not-for-profit organizations. Under these standards, investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statements of financial position. Realized and unrealized gains (losses) on investments, interest, and dividends are included in the change in unrestricted net assets in the accompanying statements of changes in net assets, unless donor or law restricted the use of the income or loss.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the value of investment securities will occur in the near term.

(h) *Property and Equipment*

Property and equipment are recorded at cost and depreciated over the estimated useful life of each class of depreciable assets, using the straight-line method. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Estimated useful lives of capital assets are as follows:

	<u>Years</u>
Land improvements	20 years
Buildings	25 years
Vehicles	5 years
Equipment	3–15 years

(i) *Deferred Financing Costs*

Deferred financing costs are amortized a straight-line basis, over the term of the related debt.

(j) *Due to Patients and Third Parties*

Due to patients and third parties includes patient deposits for services to be performed and refunds due to third parties for overpayments. Patient deposits are recognized as income as charges are incurred. Any unearned deposits are returned to patients subsequent to discharge.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

(k) Net Assets

The net assets of the Hospital and changes therein are classified and reported as follows:

Unrestricted Net Assets – unrestricted net assets are those whose use is not restricted by donors, even though their use may be limited in other respects, such as by contract, board designation, or under debt agreements.

Temporarily and Permanently Restricted Net Assets – temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

(l) Excess of Revenues, Gains, Other Support, and Nonoperating Gains (Losses) over Expenses

The statements of operations include the excess of revenues, gains, other support, and nonoperating gains (losses) over expenses. Changes in unrestricted net assets that are excluded from excess of revenues, gains, other support, and nonoperating gains (losses) over expenses, consistent with industry practice, include changes in net unrealized losses on other than trading securities and net assets released from restriction for use in capital projects.

(m) Net Patient Service Revenue

The Hospital has agreements with third-party payors, which provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retrospective adjustments under reimbursement agreements with third-party payors. Retrospective 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.

(n) Charity Care

The Hospital provides care to patients who meet certain criteria established under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of accounts determined to qualify as charity care, they are not reported as revenue. The cost of providing charity care is estimated by multiplying total charges incurred by the patients that qualify for financial assistance by an overall ratio of costs to charges. The cost of providing charity care was \$448,350 and \$408,800 for the years ended February 28, 2014 and 2013, respectively.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

(o) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. Fair value is estimated giving consideration to anticipated future cash receipts (after allowance is made for uncollectible contributions) and discounting such amounts at a risk-adjusted rate commensurate with the duration of the donor's payment plan. These inputs to the fair value estimate are considered Level 3 in the fair value hierarchy.

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 statements of operations and changes in net assets as net assets released from restrictions. In the absence of donor specifications that income and gains on donated funds are restricted, such donated funds are reported as income and gains within the accompanying statements of operations.

In fiscal years 2014 and 2013, the Hospital released \$500,000 of donor-restricted funds designated as scholarships for patient treatment.

(p) Income Taxes

The Hospital is qualified as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (the Code), and as such, no provision for income taxes has been recorded. The Internal Revenue Service informed the Hospital by a letter dated June 23, 1937 that the Hospital's operations are designed in accordance with such section of the Code. There are certain transactions that could be deemed "Unrelated Business Income" and would result in a tax liability. Management reviews transactions to estimate potential tax liabilities. The Hospital recognizes income tax positions when it is more-likely than not that the position will be sustainable based on the merits of the position. Management has concluded that there are no uncertain tax positions that needed to be recorded at February 28, 2014 and 2013.

(q) Use of Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The use of estimates and assumptions in the preparation of the accompanying financial statements is primarily related to the Hospital's determination of the net patient accounts receivable and settlements with third-party payors. Due to uncertainties inherent in the estimation and assumption process, actual results could differ from those estimates and such differences could be material (note 2).

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

(r) ***Healthcare Reform Legislation***

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the Health Reform Law), which was signed into law on March 23, 2010, will change how healthcare services are covered, delivered, and reimbursed through expanded coverage of uninsured individuals, reduced growth in Medicare program spending, and the establishment of programs in which reimbursement is tied to quality and integration. In addition, the Health Reform Law reforms certain aspects of health insurance, expands existing efforts to tie Medicare payments to performance and quality, and contains provisions intended to strengthen fraud and abuse enforcement. Because of the many variables involved with the Health Reform Law, the Hospital's management is unable to predict the net effect on the Hospital of the expected increases in insured individuals using its facilities, the reductions in Medicare spending and funding, and numerous other provisions in the law that may affect the Hospital.

(s) ***Budget Control Act***

The Budget Control Act of 2011 (the Budget Control Act) mandated significant reductions and spending caps on the federal budget for fiscal years 2013 through 2021. The Budget Control Act also created a Joint Select Committee on Deficit Reduction (the Super Committee) to develop a plan to further reduce the federal deficit by \$1.5 trillion on or before November 23, 2011. Since the Super Committee failed to act before the mandated deadline, a 2% reduction in Medicare spending, among other reductions, became effective as of March 1, 2013, in a process known as Sequestration. Hospital nonphysician Medicare payments were reduced by the mandatory 2% reduction for claims with dates of service or dates of discharge on or after April 1, 2013.

Physician services are reimbursed by Medicare under the physician fee schedule (PFS) system, under which Medicare has assigned a national relative value unit (RVU) to most medical procedures and service that reflects the various resources required by a physician to provide the services relative to all other services. The PFS system includes a formula that limits the targeted growth in Medicare expenditures referred to as the sustainable growth rate (SGR). The PFS rates are adjusted each year, and reductions in both current and future payments are anticipated. The SGR formula, if implemented as mandated by statute, would result in significant reductions to payments under the PFS. Since 2003, the Congress has passed multiple legislative acts delaying application of the SGR to the PFS. The most recent legislation delays application of the SGR until March 1, 2015. It cannot be predicted whether Congress will intervene to prevent this reduction to payments in the future. Barring delay or repeal of the SGR by Congress, Medicare payments to physicians are scheduled to be cut by more than 21% effective March 1, 2015. In fiscal years 2014 and 2013, respectively, Medicare net patient revenue was approximately \$1.5 million, or 4% of the Hospital's net patient revenue.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

(2) Net Patient Service Revenue and Accounts Receivable

The Hospital has agreements with third-party payors, which provide for reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's billings at list price and the amounts reimbursed by Medicare, Blue Cross, and certain other third-party payors, and any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. Contractual adjustments under third-party reimbursement programs are accrued on an estimated basis in the period the related services are rendered and are adjusted in future periods as final settlements are determined. A summary of the basis of reimbursement with major third-party payors is as follows:

(a) Medicare

The Hospital is paid for inpatient services rendered to Medicare program beneficiaries under the Inpatient Psychiatric Facility Prospective Payment System, which was implemented in 2005. For both years ended February 28, 2014 and 2013, net revenue from the Medicare program accounted for approximately 4% of the Hospital's net patient service revenue, in both years.

Laws and regulations governing the Medicare programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change 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. While no such regulatory inquiries have been made, 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 programs.

(b) Managed Care Organizations

The Hospital has also entered into reimbursement agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes contractual allowances from established charges and prospectively determined per diem rates.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

Patient revenue, net of contractual allowances, is reduced by the provision for bad debts, and net patients accounts receivable are reduced by an allowance for doubtful accounts. These amounts are based on historical and expected write-offs and net collections as well as aging status. Based on historical experience, a portion of the Hospital's self-pay patients who do not qualify for charity care will be unable or unwilling to pay for services provided. Thus, the Hospital records a provision for bad debts related to these patients in the period the services are provided. For the years ended February 28, 2014 and 2013, patient service revenue (including patient co-pays and deductibles), net of contractual allowances (but before the provision for uncollectible accounts) by major payor source was as follows:

	2014	2013
Medicare	\$ 1,473,864	1,505,694
Third-party payors	19,429,679	17,465,175
Self pay	17,218,994	16,036,636
Total	\$ 38,122,537	35,007,505

Patient accounts receivable, including patient co-pays and deductibles by major primary payor source, before deducting allowance for doubtful accounts were the following as of February 28, 2014 and 2013:

	2014	2013
Medicare	5%	11%
Blue Cross	19	23
Other third-party payors	55	53
Self-pay	21	13
	100%	100%

Patient accounts receivable, net of contractual adjustments were \$3,975,813 and \$4,198,467 as of February 28, 2014 and 2013, respectively, or 10% and 12% net of patient revenue for the fiscal years then ended. The related allowance for uncollectible accounts was \$721,651 and \$470,948 or 18% and 11% of the related patient accounts receivable, net of contractual allowances as of February 28, 2014 and 2013. The Hospital wrote off \$260,773 and \$250,704 in bad debts and denials, net of recoveries, in fiscal years 2014 and 2013, respectively.

For the years ended February 28, 2014 and 2013, the provision for bad debt includes a favorable change in estimate related to the allowance for doubtful accounts, which increased the Hospital's net income by \$225,700 and \$483,400, respectively.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

(3) Assets Limited or Restricted as to Use and Investments

Assets limited or restricted as to use and investments consisted of the following as of February 28, 2014 and 2013:

	2014	2013
Assets limited or restricted as to use:		
Cash and cash equivalents	\$ 1,959,423	2,323,699
Donor restricted assets:		
Mutual funds	831,369	824,848
	831,369	824,848
Liquid reserve requirement:		
Cash and cash equivalents	500,000	500,000
Mutual funds	1,000,000	1,000,000
	1,500,000	1,500,000
Total assets limited as to use	4,290,792	4,648,547
Less current portion	(1,959,423)	(2,323,699)
Assets limited or restricted as to use, net of current portion	2,331,369	2,324,848
Investments:		
Mutual funds	6,687,905	4,419,859
Equities	—	1,103
Total investments	6,687,905	4,420,962
Total assets limited or restricted as to use and investments	\$ 10,978,697	9,069,509

Current liabilities, for which assets are limited or restricted as to use, consisted of the following as of February 28, 2014 and 2013:

	2014	2013
Hospital 401(k) contribution due to employees	\$ 850,736	773,715
Due to patients and third parties	1,108,687	1,549,984
Total current liabilities	\$ 1,959,423	2,323,699

Hospital 401(k) contributions due to employees are included in accrued salaries, taxes, and other compensation in the accompanying statements of financial position.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

The cost and market values of all investments, including those categorized as assets limited or restricted as to use, are summarized as follows as of February 28, 2014 and 2013:

		2014		
		Cost	Unrealized gains (losses)	Fair value
Investments:				
Mutual funds:				
Fixed income – domestic	\$	3,905,130	11,840	3,916,970
Domestic		2,708,506	972,581	3,681,087
International		780,413	140,804	921,217
	\$	<u>7,394,049</u>	<u>1,125,225</u>	<u>8,519,274</u>
		2013		
		Cost	Unrealized gains (losses)	Fair value
Investments:				
Mutual funds:				
Fixed income – domestic	\$	3,364,380	79,450	3,443,830
Domestic		1,806,745	435,481	2,242,226
International		512,101	46,550	558,651
		<u>5,683,226</u>	<u>561,481</u>	<u>6,244,707</u>
Equities:				
Domestic		<u>1,114</u>	<u>(11)</u>	<u>1,103</u>
	\$	<u>5,684,340</u>	<u>561,470</u>	<u>6,245,810</u>

Financial Accounting Standards Board (FASB) Accounting Standards Codification 820, *Fair Value Measurement*, establishes a formal hierarchy and framework for measuring fair value and expands disclosure about fair value measurements and the reliability of valuation impacts. The guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Observable inputs other than Level 1 prices such as quoted prices for similar instruments; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities include those whose value is determined using pricing models, discounted cash flows methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

At February 28, 2014 and 2013, the Hospital estimated the fair value of all of its investments based on Level 1 inputs. The Hospital does not have any Level 2 or 3 assets or liabilities as of February 28, 2014 and 2013.

(4) Property and Equipment

At February 28, 2014 and 2013, property and equipment consist of the following:

	<u>2014</u>	<u>2013</u>
Land and land improvements	\$ 5,250,788	4,436,224
Buildings	36,192,285	33,279,409
Vehicles	475,135	422,082
Equipment	6,949,442	6,296,611
Construction in progress	3,111,236	3,346,742
	<u>51,978,886</u>	<u>47,781,068</u>
Less accumulated depreciation	<u>(19,810,903)</u>	<u>(17,951,051)</u>
	<u>\$ 32,167,983</u>	<u>29,830,017</u>

During fiscal year 2013, the Hospital purchased residential land and buildings, adjacent to the Hospital property, for approximately \$5.3 million. The Hospital plans to renovate and convert one of the buildings into a patient care area.

As of February 28, 2013, construction in progress consisted of renovation expenditures for River House and other projects. The River House renovations were completed and placed into service during the fiscal year ended February 28, 2014. As of February 28, 2014, construction in progress consists of renovation expenditures for bridges on the property and various other projects.

(5) Long-Term Debt

Long-term debt is comprises of the following at February 28:

	<u>2014</u>	<u>2013</u>
Mortgage (a)	\$ 1,941,274	1,985,905
Mortgage (b)	2,264,828	2,316,010
	<u>4,206,102</u>	<u>4,301,915</u>
Less current portion	<u>(100,276)</u>	<u>(95,813)</u>
	<u>\$ 4,105,826</u>	<u>4,206,102</u>

(a) In September 2012, the Hospital entered into a loan agreement for \$2,000,000 with the bank to finance the purchase of the property at 225 Valley Road, which is contiguous to the Hospital grounds. The term of the loan is 10 years, with a 25-year amortization period and a fixed interest rate of 4.5%. Monthly principal and interest payments of \$11,191 commenced on November 1, 2012 and

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

are payable through September 1, 2022, with a balloon payment of \$1,462,150 and any unpaid interest due on October 1, 2022. The loan is secured by the property. Interest incurred on the loan was \$89,502 in 2014 and \$42,369 in 2013.

- (b) The Hospital entered into another loan agreement with the bank for \$2,320,000 to finance the purchase of the contiguous property at 134 Valley Road. The term of the loan is 10 years, with a 25-year amortization period and a fixed interest rate of 4.5%. Monthly principal and interest payments of \$12,980 commenced on February 1, 2013 and are payable through December 1, 2022, with a balloon payment of \$1,695,879 and any unpaid interest due on January 1, 2023. The loan is secured by the property. Interest incurred on the loan was \$104,400 in 2014 and \$22,606 in 2013.

Aggregate principal payments on long-term debt for the next five years and thereafter are as follows:

Year ending February 28:	
2015	\$ 100,276
2016	104,949
2017	109,317
2018	114,932
2019	120,287
Thereafter	<u>3,656,341</u>
	<u>\$ 4,206,102</u>

(6) Line of Credit

In 2007, the Hospital entered into a revolving line of credit, with a term of 10 years and a maximum available borrowing of \$10,000,000, which was secured by the land and buildings owned by the Hospital. Interest was charged monthly at a rate of 7.15%. In December 2010, the line-of-credit agreement was modified to include an interest rate of 5.25% and an extension of the term to 10 years. In September 2012, the line-of-credit agreement was modified again to extend the 10-year term an additional year. The modified line revolves for a period of four years, with interest payments due monthly based on the balance outstanding. On December 31, 2015, the line will convert to a permanent commercial mortgage for the remaining 6 years of the term. Upon conversion, principal and interest payments will be due monthly through December 31, 2021 at which time a balloon payment for any unpaid principal and interest will be due.

In April 2012, the Hospital repaid \$5,000,000 of the outstanding line, liquidating \$4,000,000 of investments to cover a portion of the repayment, and leaving an outstanding line-of-credit balance of \$127,680 as of February 28, 2013. There were no borrowings in fiscal year 2014 therefore the outstanding balance on the line of credit was \$127,680 as of February 28, 2014. In 2014, interest incurred on the line was \$6,796. In 2013, interest incurred on the line was \$56,744.

As part of the line-of-credit and loan agreements (mortgages) (footnote 5), the Hospital must maintain a compensating balance at the bank of \$500,000. The line-of-credit and loan agreements (mortgages) require an aggregate liquid reserve of \$1,500,000 to be maintained over the term of the debt, which is included in assets limited or restricted as to use.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

(7) Lease Obligations

The Hospital has noncancelable operating leases, which expire through February 2017. Future minimum lease payments under these noncancelable operating leases are as follows:

Year ending February 28:		
2015	\$	335,361
2016		93,572
2017		34,272
2018		23,264
2019		23,264
		<hr/>
	\$	<u>509,733</u>

Rental expense for all operating leases totaled approximately \$307,793 in 2014 and \$302,600 in 2013. Rental expenses are included in supplies and services expenses on the statements of operations.

(8) Commitments and Contingencies

Insurance

As of February 28, 2014, the Hospital maintains professional and general liability insurance coverage on a claims-made basis. The claims-made policy, which is subject to renewal on an annual basis, covers only claims made during the term of the policy but not those occurrences for which claims may be made after expiration of the policy. Coverage under the policy is \$1 million per occurrence, with an aggregate limit of \$3 million. The Hospital also maintains an excess umbrella policy, which provides \$8 million of additional coverage.

The Hospital engaged an actuary to determine an undiscounted estimate of losses from unasserted claims and incidents that may have occurred but have not been reported as of February 28, 2014 and 2013, respectively. The actuarial evaluation is based on the Hospital's historical experience, industry data, and other considerations. As of February 28, 2014 and 2013, the Hospital has accrued the following for losses from unasserted claims and incidents that may have occurred but have not been reported:

	<u>2014</u>	<u>2013</u>
Estimated malpractice liabilities	\$ 1,554,480	1,469,075
Insurance claims receivable	(1,045,665)	(1,045,651)

The Hospital is party to routine litigation arising in the ordinary course of business. Although some of the matters are still in a preliminary stage and definite conclusions cannot be made as to those matters, the Hospital is of the opinion that based on information presently available, the lawsuits will not have a materially adverse effect on the financial statements of the Hospital.

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

Dining Services Contract

The Hospital contracts with Unidine to provide food service to its patients. The contract is cancelable by either party if the other party fails to perform all of its material obligations as outlined in the agreement. The cost is approximately \$27,800 per week.

(9) Retirement Plan

The Hospital has a 401(k) defined-contribution plan (401(k) Plan) that covers all full-time employees who have both attained age 21 and completed at least 1,000 hours of service during the first year of employment. The 401(k) Plan provides for an employer-based contribution allowing the Hospital to make contributions ranging from 2.5% to 7.5% of each participant's annual compensation, depending on years of vested service. Employees may also make annual contributions up to the amount permitted by law. Expenses related to the 401(k) Plan were approximately \$745,840 and \$674,090 for the years ended February 28, 2014 and 2013, respectively, and are included within employee benefits within the accompanying statements of operations.

(10) Functional Expenses

The Hospital provides psychiatric and substance abuse healthcare services to residents within its geographic location. Expenses related to providing these services included in the statements of operations are as follows:

	<u>2014</u>	<u>2013</u>
Healthcare services	\$ 28,867,487	26,176,330
Development	571,757	575,169
General and administrative	<u>6,006,468</u>	<u>5,777,208</u>
	<u>\$ 35,445,712</u>	<u>32,528,707</u>

(11) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes as of February 28, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Scholarship fund for young adults	\$ 9,613	15,594
Scholarship fund	579,378	581,493
Employee assistance fund	13,693	13,428
Other funds	<u>15,685</u>	<u>1,333</u>
	<u>\$ 618,369</u>	<u>611,848</u>

SILVER HILL HOSPITAL, INC.

Notes to Financial Statements

February 28, 2014 and 2013

Permanently restricted net assets of \$213,000 at February 28, 2014 and 2013 consist of donor-restricted funds to be maintained by the Hospital in perpetuity. The income generated from permanently restricted funds is expendable for purposes designated by donors, including adolescent and chemical dependency program services.

(12) Subsequent Events

The Hospital has evaluated and disclosed subsequent events from the statement of financial position date of February 28, 2014 through June 25, 2014, which is the date the financial statements were available to be issued, and concluded that no additional disclosures were required.